

Before the
Federal Communications Commission
Washington, D.C. 20554

Report in Response to)
Senate Bill 1768 and)
Conference Report on H.R. 3579)

REPORT TO CONGRESS

Adopted: May 8, 1998

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By the Commission: Commissioner Ness issuing a statement; Commissioners Furchtgott-Roth and Powell dissenting and issuing separate statements.

1. In connection with supplemental appropriations legislation enacted on May 1, 1998, Congress requested that the Commission prepare a two-part report to Congress (the Report), addressing certain issues concerning the implementation of the federal universal service support mechanisms.¹ Section 2005(b)(2)² of the Senate bill directs the proposal of a single

¹ On April 30, 1998, both the U.S. Senate and U.S. House of Representatives passed H.R. 3579, which makes emergency supplemental appropriations for fiscal year 1998. As passed by the Senate and the House, H.R. 3579 was signed into law by President Clinton on May 1, 1998. The Conference Report on H.R. 3579 eliminated from the final bill specific legislative language contained in S. 1768, the supplemental appropriations bill adopted by the Senate on March 31, 1998 (the Senate bill). Section 2005 of the Senate bill had directed the Commission to prepare and submit to Congress by May 8th a two-part report on universal service. The statement of the House-Senate conferees accompanying the final bill nevertheless expresses the expectation that, among other things, "the FCC will comply with the reporting requirement in the Senate bill, respond to inquiries regarding the universal service contribution mechanisms, access charges and cost data, and propose a new structure for the implementation of the universal service programs." Conference Report on H.R. 3579, H. Rept. 105-504.

² Section 2005(b) of the Senate bill provided in pertinent part: "(1) Report Due Date -- Pursuant to the findings of the General Accounting Office (B-278820) dated February 10, 1998, the Federal Communications Commission shall, by May 8, 1998, submit a 2-part report to the Congress under this section. (2) Revised

entity to administer the support mechanisms for schools and libraries and rural health care providers, and further directs that the proposal be "pursuant to the findings of the GAO."³ In response to this directive, and based on the Commission's charge to ensure the effective delivery of universal service support to targeted recipients under the Communications Act of 1934 (the Act), the Commission proposes in Part I of this Report that the Universal Service Administrative Company (USAC), the current Administrator of the high cost and low income support mechanisms, also administer the universal service support mechanisms for schools and libraries and rural health care providers. As described below, this proposal would be responsive to the Senate bill's request and preserve the goals sought by the Commission in establishing the current structure, while minimizing disruption of the on-going administration of the universal service support mechanisms.

2. Part II of the following Report supplies information concerning funding and disbursements for the schools and libraries support mechanism. This information, as provided below, demonstrates the efficient, innovative, and effective administration of this important new support mechanism.

I. REVISED ADMINISTRATIVE STRUCTURE

A. Background

3. In the Telecommunications Act of 1996 (1996 Act), Congress directed the Commission and the states to take the steps necessary to establish universal service support mechanisms to ensure the delivery of affordable telecommunications services to all Americans.⁴ The 1996 Act codified long-standing federal rules and policies designed to make basic telephone service affordable throughout the nation. In addition, the 1996 Act included for the first time schools and libraries among the eligible beneficiaries of the federal universal service support mechanisms by providing that elementary schools, secondary schools, and libraries are entitled to

Structure -- The report shall propose a revised structure for the administration of the programs established under section 254(h) of the Communications Act of 1934 (47 U.S.C. 254(h)). The revised structure shall consist of a single entity."

³ In response to a letter from Senator Stevens to the General Accounting Office (GAO) concerning the establishment of the Schools and Libraries Corporation (SLC) and the Rural Health Care Corporation (RHCC), the GAO concluded that the Commission lacked authority to direct the National Exchange Carriers Association (NECA), as a condition of its appointment as temporary Administrator, to create SLC and RHCC. Letter from the Office of General Counsel, General Accounting Office, to the Honorable Ted Stevens, United States Senate, dated February 10, 1998.

⁴ 47 U.S.C. § 254(b)(3).

receive, upon a bona fide request, any of the core universal services at discounted rates.⁵ Congress further directed the Commission to "establish competitively neutral rules . . . to enhance, to the extent technically feasible and economically reasonable, access to advanced telecommunications and information services for all public and non-profit elementary and secondary school classrooms, health care providers, and libraries."⁶

4. On November 8, 1996, the Federal-State Joint Board on Universal Service (Joint Board) released a Recommended Decision, which included a proposal that the Commission appoint NECA as the temporary Administrator of the new universal service support mechanisms.⁷ The Joint Board also recommended that, prior to appointing NECA as temporary Administrator, the "Commission permit NECA to add significant, meaningful representation" for non-incumbent local exchange carrier (LEC) interests to the NECA Board of Directors.⁸ NECA was established in 1983 as an association of incumbent LECs to administer the interstate access tariff and revenue distribution processes.⁹ NECA's responsibilities subsequently included, among other things, administering the universal service high cost fund, the Lifeline Assistance program, the long term support program and the interstate Telecommunications Relay Services fund.¹⁰ Because of NECA's appearance of bias toward incumbent LECs based on the composition of its membership and Board of Directors, the Joint Board declined to recommend the appointment of NECA as the permanent Administrator of the universal support mechanisms, but did recommend that the Commission remove any regulatory barriers to NECA's rendering itself a neutral third party.¹¹

⁵ 47 U.S.C. § 254(h)(1)(B). In addition to the services included in the definition of universal service under section 254(c)(1), Congress specified that the Commission "may designate additional services for such support mechanisms for schools, libraries, and health care providers." 47 U.S.C. § 254(c)(3).

⁶ 47 U.S.C. § 254(h)(2)(A).

⁷ Federal-State Joint Board on Universal Service, Recommended Decision, 12 FCC Rcd 87 (rel. Nov. 8, 1996)(Recommended Decision) at ¶ 833.

⁸ Id.

⁹ See generally, MTS and WATS Market Structure, Third Report and Order, CC Docket No. 78-72, Phase I, 93 FCC 2d 241 (1983). See also 47 C.F.R. § 69.601.

¹⁰ See generally, Changes to the Board of Directors of the National Exchange Carrier Association, Inc., Notice of Proposed Rulemaking and Notice of Inquiry, CC Docket No. 97-21, FCC 97-2 (rel. Jan. 10, 1997), errata, mimeo 71784, CC Docket No. 97-21 (rel. Jan. 15, 1997) at ¶ 3.

¹¹ Recommended Decision at ¶ 833.

5. The Commission's Common Carrier Bureau issued a public notice generally seeking comment on the Joint Board's recommendations,¹² and the Commission subsequently issued a Notice of Proposed Rulemaking and Notice of Inquiry specifically seeking comment on "how the Commission should amend its rules so that NECA can reform its Board of Directors in a manner that will enable it to become eligible to serve as the temporary administrator of the universal service support mechanisms."¹³ The Commission also sought guidance from the General Accounting Office (GAO) as to how to establish an appropriate administration for federal universal service.¹⁴

6. In the Universal Service Order released on May 8, 1997, the Commission appointed NECA as the temporary Administrator of the universal service support mechanisms established under section 254 of the Act, consistent with the Joint Board's recommendation, subject to NECA's agreement to make changes to its governance that would render it more representative of the interests of entities other than incumbent local exchange carriers.¹⁵ The Commission recognized that NECA's membership and governance, comprised of incumbent local exchange carriers, was not sufficiently representative to ensure competitively neutral administration of the support mechanisms as required by the statute. Previously, NECA had submitted formal proposals expressing its interest in administering the universal service support mechanisms. In a January 10, 1997 letter,¹⁶ NECA proposed the creation of a wholly-owned subsidiary, designated as the Universal Service Administrative Company (USAC), for this purpose. In an order released on July 18, 1997,¹⁷ the Commission determined that NECA's January 10, 1997 proposal, with some modifications, would satisfy the conditions established in

¹² FCC Common Carrier Bureau Public Notice Seeking Comment on Universal Service Recommended Decision, DA 96-1891 (Nov. 18, 1996).

¹³ Changes to the Board of Directors of the National Exchange Carrier Association, Inc., Notice of Proposed Rulemaking and Notice of Inquiry, CC Docket No. 97-21, FCC 97-2 (rel. Jan. 10, 1997), errata, mimeo 71784, CC Docket No. 97-21 (rel. Jan. 15, 1997) at ¶ 2.

¹⁴ Letter from Chairman, Reed E. Hundt, FCC, to J. Dexter Peach, Assistant Comptroller General, General Accounting Office, dated January 31, 1997.

¹⁵ Federal-State Joint Board on Universal Service, First Report and Order, CC Docket No. 96-45, FCC 97-157 (rel. May 8, 1997), appeal pending sub nom. in Texas Office of Util. Counsel No. 97-60421 (5th Cir. filed June 25, 1997) (Universal Service Order), at ¶ 866.

¹⁶ Letter from Bruce Baldwin, NECA, to Chairman Reed E. Hundt, FCC, dated January 10, 1997.

¹⁷ Changes to the Board of Directors of the National Exchange Carrier Association, Inc., Federal-State Joint Board on Universal Service, Report and Order and Second Order on Reconsideration, 12 FCC Rcd 18400, FCC 97-253, CC Docket No. 97-21 (rel. July 18, 1997) (July 18, 1997 Order).

the Universal Service Order. Accordingly, the Commission directed NECA, as a condition of its appointment as the temporary Administrator, to establish an independent subsidiary, USAC, to administer temporarily the high cost and low income support mechanisms and to perform billing, collection, and disbursement functions for all of the universal service support mechanisms on a temporary basis.¹⁸ The Commission further determined to establish a universal service advisory committee, pursuant to the Federal Advisory Committee Act,¹⁹ that would recommend to the Commission a neutral third party to assume these functions on a permanent basis.²⁰ The Commission also directed NECA, as a condition of its appointment as the temporary Administrator, to establish two independent corporations, the Schools and Libraries Corporation (SLC) and Rural Health Care Corporation (RHCC), to administer portions of the support mechanisms for schools and libraries, and rural health care providers, respectively.²¹ These corporations would serve as permanent administrators of those mechanisms.²²

7. This administrative structure was intended to accomplish three goals. First, the Commission concluded that specialized entities, comprised of individuals with particular expertise, would foster efficient and effective administration.²³ Second, the Commission sought both to increase accountability to the Commission for the administration of schools, libraries, and rural health care support, and to provide adequate safeguards against waste, fraud, and abuse.²⁴ Finally, in directing the establishment of SLC and RHCC as permanent entities, the Commission

¹⁸ July 18, 1997 Order, 12 FCC Rcd at 18418, ¶ 30.

¹⁹ 5 U.S.C. App. §§ 4(a) and 3(2)(C).

²⁰ July 18, 1997 Order, 12 FCC Rcd at 18432, ¶ 60. In NECA's January 10, 1997 letter, it further proposed that, if USAC were ultimately selected as permanent Administrator, NECA would at that time spin off USAC as a separate corporate entity, unaffiliated with NECA. Letter from Bruce Baldwin, NECA, to FCC Chairman Reed E. Hundt, dated January 10, 1997.

²¹ July 18, 1997 Order, 12 FCC Rcd at 18430, ¶ 57.

²² July 18, 1997 Order, 12 FCC Rcd at 18431, ¶ 59.

²³ July 18, 1997 Order, 12 FCC Rcd at 18436-37, ¶ 68. The board of directors of each administering corporation includes representatives from entities that have expertise in the particular support mechanism being administered. For example, the SLC board includes representatives from school and library organizations, as well as a telecommunications industry representative. The RHCC board includes two rural health care representatives and a telecommunications industry representative. Including these members with specialized knowledge helps ensure that these support mechanisms will be responsive to the specific needs and operational practices of educational institutions and rural health care providers.

²⁴ July 18, 1997 Order, 12 FCC Rcd at 18439-41, ¶¶ 75-77. For a discussion of these safeguards, see *infra*.

sought continuity in the administration of the support mechanisms for schools, libraries, and rural health care providers.²⁵

B. Discussion

8. Revised Administrative Structure. Consistent with the directive of section 2005(2)(b)(2) of the Senate bill, to which Congress has requested that we respond, we propose to merge SLC and RHCC into USAC as the single entity responsible for the administration of the universal service support mechanisms for schools, libraries, and rural health care providers.²⁶ In our view, vesting the consolidated USAC with the administrative responsibilities for all of the universal service support mechanisms, as described below, may best further the goals of efficient administration and accountability, and therefore would likely be the best option in accordance with the language of section 2005 to propose a single entity to administer the schools and libraries and rural health care support mechanisms. The USAC board includes individuals with the experience and expertise necessary to understand and implement the distinct missions of the schools and libraries and rural health care support mechanisms. The majority of the members of the boards of directors for SLC and RHCC, including representatives of schools and libraries and rural health care providers, also serve on the USAC board of directors.²⁷ In addition, USAC is already responsible for collecting and disbursing funds for the schools, libraries, and rural health care support mechanisms and has put systems in place for this purpose. Accordingly, subject to the Commission adopting a plan of reorganization that satisfies the criteria for efficient and accountable administration described below, we tentatively conclude that such a unified entity would be uniquely qualified to assume responsibility for the administration of these support mechanisms. As described more fully below, to preserve the distinct missions, expertise, and integrity of the schools and libraries and rural health care support mechanisms, board committees or divisions within USAC may be appropriate.

²⁵ July 18, 1997 Order, 12 FCC Rcd at 18431-32, ¶ 59. The Commission concluded that it would be best to provide permanence and certainty with respect to the administration of universal service support, to the extent possible. If the schools and libraries and the rural health care mechanisms were administered by or affiliated with NECA or USAC, they would not serve in a permanent capacity unless USAC ultimately were selected as the permanent Administrator. Requiring a temporary Administrator to build the expertise necessary to run these support mechanisms, and then to rebuild that expertise in a permanent Administrator, would have been unduly disruptive and wasteful.

²⁶ Consistent with the requirements of section 2005(b)(2) of the Senate bill, the "single entity" responsible for administering the support mechanisms for schools, libraries, and rural health care would be USAC. USAC also would continue to administer the high cost and low income support mechanisms.

²⁷ The overlapping board structure between USAC and SLC, and USAC and RHCC, was intended to ensure close coordination of both administrative and substantive obligations of the three corporations.

9. The consolidated USAC will remain accountable to the Commission by virtue of the Commission's universal service rules,²⁸ which provide detailed guidance on administration of the universal service support mechanisms, USAC's regular coordination with Commission staff, and its quarterly filing of projected administrative expenses and estimates of support mechanism demand. The Commission also oversees the structure and content of the annual independent audit that USAC is required to undertake.²⁹ As explained to the General Accounting Office, the Commission retains ultimate authority over the operation of the support mechanisms.³⁰ Parties that object to any action taken by the corporations can bring the matter to the Commission's attention and request remedial relief. As outlined in greater detail below, we also propose in this Report a procedure for administrative review of USAC's decisions by the Commission. Moreover, we believe that naming USAC as the permanent Administrator, as proposed in this Report, would provide continuity to support mechanism contributors and beneficiaries. As a permanent Administrator, USAC's development of expertise and operational success of the support mechanisms would be encouraged fully, and not undermined by the danger that its expertise would have to be rebuilt at some near date in the future. Such a midstream change could potentially be disruptive and wasteful. Finally, USAC satisfies the statutory requirement of competitively neutral administration because it includes significant industry-wide representation of both contributors and beneficiaries.

10. USAC's Reorganization Plan. In response to the directive of section 2005 of the Senate bill, we propose that the functions, assets, employees, rights, and liabilities of SLC and RHCC be transferred to USAC by January 1, 1999. To implement the transfer, USAC, SLC and RHCC would be required jointly to prepare and submit a plan of reorganization for approval by the Commission. Prior to taking final action consistent with any proposals, public comment on such proposals will be sought. In addition, after reviewing the reorganization plan, and any comments received, the Commission contemplates ultimately effectuating the unified structure proposed herein through issuing a reconsideration order.³¹ The reorganization plan must detail how USAC proposes to structure its organization and operations pursuant to established principles and requirements of corporate law, and the language of section 2005 of the Senate bill.

²⁸ 47 C.F.R., Parts 54 and 69.

²⁹ 47 C.F.R. § 69.621.

³⁰ Letter from David H. Solomon, Deputy General Counsel, FCC, to Michael R. Volpe, Assistant General Counsel, General Accounting Office, dated January 5, 1998.

³¹ Pursuant to section 410(c) of the Act, the Commission would consult with the state joint board members before reaching a final decision on these issues. 47 U.S.C. § 410(c).

11. We contemplate that the specialized knowledge and expertise of SLC and RHCC would be maintained in the unified structure. The joint proposal must be responsive to the direction of the Conference Report that "any proposed administrative structure should take into account the distinct mission of providing universal service to rural health care providers, and include recommendations as necessary to assure the successful implementation of this program."³² To that end, the existing SLC and RHCC boards may become subsidiaries or committees of the USAC board.³³ In addition, the reorganization plan must delineate how the administrative systems and expertise that RHCC and SLC have developed, which differ from those required to administer the high cost and low income support mechanisms, will be preserved in USAC. The plan may also include a proposed organizational framework for staffing within USAC involving divisions or other operational units charged with discrete or specialized duties. Finally, to provide continuity to the beneficiaries and recipients of the support mechanisms during the period of reorganization, the plan must address the transfer of employees' contractual rights,³⁴ benefits, and obligations of SLC and RHCC, including the assumption of contracts for services that SLC and RHCC have entered into with subcontractors in connection with the performance of their administrative responsibilities.

12. USAC's Permanence and Divestiture. Given USAC's successful administration of the support mechanisms to date, we propose that the administrative structure set forth herein be made permanent, subject to the Commission's review and determination after one year that the new structure is administering the distribution of universal service support and benefits to eligible entities in an efficient, effective, and competitively neutral manner.³⁵ Providing permanence to the

³² Conference Report on H.R. 3789, H. Rept. 105-504.

³³ In particular, we contemplate that any such proposed operational units have the power to bind the USAC Board on certain specialized matters comparable to the power and authority vested in the current High Cost and Low Income Committee of USAC. This power should include the ability to make binding decisions on issues related to the administration of the schools and libraries and rural health care support mechanisms, but not on issues related to USAC's billing, collection and disbursement functions. See, e.g., July 18, 1997 Order, at ¶¶ 52 - 56.

³⁴ In particular we note that, in the Conference Report on H.R. 3579, the conferees concur with section 2005(c) of the Senate bill relating to compensation for employees administering the support mechanisms for schools and libraries and rural health care. This will be addressed in the forthcoming reconsideration order. In addition, we intend to seek comment on whether the salary limitations provided in the Senate bill should apply to the officers and employees of USAC and NECA as well.

³⁵ In the Universal Service Order, the Commission determined that it would establish a federal advisory committee whose function would be to recommend to the Commission an entity to serve as the permanent Administrator. Universal Service Order, 12 FCC Rcd at 9214, ¶ 861. Adopting the revised structure proposed herein would require that the Commission eliminate the establishment of a federal advisory committee.

proposed structure will ensure USAC's ability to continue to attract and maintain qualified personnel and to ensure the continued success of the administrative operations without unnecessary disruption to contributors and beneficiaries.

13. Because we propose in this Report that USAC be named the permanent Administrator, we further propose that, pending Commission review of USAC's performance after one year, USAC be divested from NECA. This proposal is consistent with NECA's suggestion in its January 10, 1997 letter that, if USAC were selected as the permanent Administrator, USAC should be divested from its affiliation with NECA.³⁶ As recognized by both commenters and the Federal-State Joint Board on Universal Service, NECA's membership and governance, which are composed primarily of incumbent local exchange carriers, may render NECA insufficiently representative of the diverse set of contributors to, and beneficiaries of, the support mechanisms either to serve as permanent Administrator or to warrant a continuing structural affiliation between NECA and USAC.³⁷ Insofar as USAC will have been successfully operating for nearly two years, there will be no continuing need for USAC to remain affiliated with NECA to facilitate the sharing of resources and personnel. This proposal to divest USAC from NECA would not prevent USAC from entering into contracts with NECA for the performance of particular administrative functions.

14. USAC's Administrative Responsibilities and Accountability In its administration of the support mechanisms for schools and libraries and rural health care providers, we expect that USAC would apply its expertise to interpreting and applying existing decisional principles, but would not make policy or create the equivalent of new guidelines, or interpret the intent of Congress, without appropriate consultation and guidance from the Commission.³⁸ Consistent with these principles, we propose to establish a procedure under which administrative decisions made by USAC would be reviewable by the Commission. Under this procedure, an administrative decision of USAC could be appealed by affected parties to the Commission. We will seek comment on exactly how this procedure should operate. In addition, the Commission would

³⁶ Letter from Bruce Baldwin, NECA, to Reed E. Hundt, FCC, dated January 10, 1997.

³⁷ Universal Service Order, 12 FCC Rcd at 9216, ¶ 866.

³⁸ This proposal is consistent with the administrative limitations described in section 2005(b)(2)(A) of the Senate bill. Specifically, section 2005(b)(2)(A) provides: "[T]he entity proposed by the Commission to administer the programs -- (i) is limited to implementation of the FCC rules for applications for discounts and processing the applications necessary to determine eligibility for discounts under section 254(h) of the Communications Act of 1934 (47 U.S.C. 254(h)) as determined by the Commission; (ii) may not administer the programs in any manner that requires that entity to interpret the intent of the Congress in establishing the programs or interpret any rule promulgated by the Commission in carrying out the programs, without appropriate consultation and guidance from the Commission."

maintain the authority to review the decisions of USAC at any time on the Commission's own motion. Moreover, to foster greater accountability of the new USAC entity to Congress as well as the Commission, we propose that, in connection with its annual audit, USAC prepare and file with Congress and the Commission an annual report describing all significant aspects of its structure and operations for the preceding year.

15. Congressional Authorization. We understand that the Senate bill's directive to propose a revised administrative structure was sparked in part by the GAO's letter concerning the establishment of SLC and RHCC.³⁹ We welcome action by Congress to resolve the issues raised by the GAO's letter. At the same time, we believe, contrary to the GAO's analysis, that the Commission acted lawfully in directing that NECA establish SLC and RHCC as a condition of its appointment as temporary Administrator. In response to the direction in section 2005(b)(2) of the Senate bill, that the unified structure we propose be "pursuant to the findings of the GAO," we respectfully request from Congress specific statutory authority, similar to that provided in connection with numbering administration, to create or designate, on or before January 1, 1999, one or more entities, such as the Universal Service Administrative Company, to administer the federal universal service support mechanisms.⁴⁰ Such authorization would eliminate any question concerning the Commission's authority generally, and under the Government Corporation Control Act,⁴¹ to vest administrative responsibilities for the schools and libraries and rural health care support mechanisms in USAC and provide certainty to universal service contributors and beneficiaries. Similarly, we request that Congress enact legislation authorizing NECA to perform the administrative functions currently assigned to it under the Commission's rules. Finally, we ask that Congress specify that the body selected by the Commission, as well as NECA, would not be considered governmental agencies, government owned corporations, or government controlled

³⁹ Letter from the Office of General Counsel, General Accounting Office, to the Honorable Ted Stevens, United States Senate, dated February 10, 1998. As noted earlier, the GAO concluded that the Commission lacked authority to direct NECA, as a condition of its appointment as temporary Administrator, to create SLC and RHCC. We note further that, before adopting the universal service order that led to the creation of SLC and RHCC (July 18, 1997 Order) the former Chairman of the Commission sought guidance from the GAO, but the GAO declined to respond. Letter from Chairman Reed E. Hundt, FCC, to J. Dexter Peach, Assistant Comptroller General, General Accounting Office, dated January 31, 1997.

⁴⁰ The requested authority is modeled after the authority granted to the Commission in section 251(e) of the Act. That section provides in relevant part: "The Commission shall create or designate one or more impartial entities to administer telecommunications numbering and to make such numbers available on an equitable basis." 47 U.S.C. § 251(e)(1).

⁴¹ 31 U.S.C. § 9102.

corporations, subject to the requirements of federal laws governing the conduct and operations of federal agencies.⁴²

II. FUNDING FOR SCHOOLS AND LIBRARIES SUPPORT MECHANISM

16. To ensure that the benefits of the Telecommunications Act of 1996 extend to all Americans, Congress expanded universal service under the Act to provide, among other things, support to eligible schools and libraries.⁴³ In so doing, Congress recognized that, by facilitating the deployment of advanced technologies to America's classrooms, the schools and libraries support mechanism represents a direct and vital investment in the community. As described more fully below, consistent with Congress' mandate, the Commission has taken steps to assure both that the schools and libraries support mechanism is adequately funded and that the expenditures made on behalf of eligible schools and libraries are delivered effectively and efficiently.⁴⁴

A. Funds Collected for Schools and Libraries Support Mechanism.

17. The Senate bill directs three inquiries concerning contributions to the schools and libraries support mechanism. Explanations are requested, first, for the contribution mechanisms for schools and libraries support and as to whether any direct end-user charges on consumers are

⁴² Those laws would include, but not be limited to, the Federal Advisory Committee Act, the Freedom of Information Act, the Privacy Act, the Government in the Sunshine Act, Title 5: Employee Classification, Title 5: Pay Rates and Rate System, Chapter 71 of Title 5, Chapter 73 of Title 5, Chapter 75 of Title 5, Federal Property and Administrative Services Act, the Federal Tort Claims Act, the Ethics in Government Act, Title 18 prohibition against bribery and conflict of interest, the Whistleblower Protection Act of 1989, Chapter 23 of Title 5, Lobbying Disclosure Act of 1995, and the Federal Election Campaign Act of 1971. Rather, we propose that Congress authorize the designation or creation of an entity without regard to the provisions of such federal laws in a manner similar to the authorization provided under section 332(b) of the Act. 47 U.S.C. § 332(b)(1)-(4).

⁴³ 47 U.S.C. § 254(h)(2)(A).

⁴⁴ For example, under the Commission's rules, schools and libraries must first post their requests for proposals, or Form 470s, on a Website opened January 30. These forms contain a description of the services requested by the school or library, organized in a manner so as to enable a provider to bid on that request. Service providers and vendors search this website for potential customers and contact the schools or library directly to bid on the account. Through this process, school administrators must negotiate with service providers to obtain the best and most cost-effective package of services. To date, reports from vendors and applicants on the competitive bidding process on the whole have been very positive. This competitive bidding process has allowed service providers to identify new customers, and schools to negotiate the lowest pre-discount price possible. In some states, like Mississippi, schools and libraries are receiving on average between eight and ten bids for every Form 470 posted on the Web. Libraries also are seeing new opportunities for service. In New York, for example, one public library reported that it had received six competitive bids on its application for a T-1 line.

appropriate;⁴⁵ and second, for the interstate and intrastate basis for such contributions consistent with section 254(d).⁴⁶ Third, an accounting is requested of the contributions available for use to support schools and libraries for the second quarter of 1998, in total⁴⁷ and as broken down by contributing entity.⁴⁸

18. Contribution Mechanism. The Commission concluded in the Universal Service Order that contributions to the universal service support mechanisms should be based on end-user telecommunications revenues.⁴⁹ The Commission found that assessing contributions based on telecommunications revenues derived from end users is competitively neutral and relatively easy to administer.⁵⁰ The Commission also found that this approach satisfied the statutory requirement that support be explicit, because carriers will know exactly how much they are contributing to the support mechanisms.⁵¹ The Commission did not mandate in the Universal Service Order that carriers recover contributions through an end-user surcharge,⁵² but did not prohibit such surcharges, and we reaffirm that conclusion herein. The Commission further stated that, in

⁴⁵ Section 2005(b)(3)(H) of the Senate bill requests: "[A]n explanation of the contribution mechanisms established by the Commission under the Commission's Report and Order (FCC 97-157), May 8, 1997, and whether any direct end-user charges on consumers are appropriate."

⁴⁶ Section 2005(b)(3)(G) of the Senate bill directs that the Commission provide: "[A]n explanation of why restricting the basis of telecommunications carriers' contributions to universal service under 254(a)(3) of the Communications Act of 1934 (47 U.S.C. 254(a)(3)) to interstate revenues, while requiring that contributions to universal service under section 254(h) of the Act (47 U.S.C. 254(h)) be based on both interstate as well as intrastate revenues, is consistent with the provisions of section 254(d) of that Act (47 U.S.C. 254(d))."

⁴⁷ Section 2005(b)(3)(B) of the Senate bill requests: "[A]n accounting of the total contributions to the universal service fund that are available for use to support the schools and libraries program under section 254(h) of the Communications Act of 1934 (4 U.S.C. 254(h)) for the second quarter of 1998."

⁴⁸ Section 2005(b)(3)(C) of the Senate bill provides that the Report contain: "[A]n accounting of the amount of the contribution described in subparagraph (b) that the Commission expects to receive from -- (i) incumbent local exchange carriers; (i) interexchange carriers; (iii) information service providers; (iv) commercial mobile radio service providers; and (v) any other provider."

⁴⁹ Universal Service Order, 12 FCC Rcd at 9206, ¶ 843.

⁵⁰ Id.

⁵¹ Id. at 9211, ¶ 854. As the Commission observed, because carriers calculate their contributions by multiplying their end-user revenues by the universal service contribution factor announced by the Commission, there will be no ambiguity regarding the cost associated with the preservation and advancement of universal service. Id.

⁵² Id. at 9210-11, ¶ 853.

declining to mandate an end-user surcharge, it sought to allow carriers the flexibility to decide how they should recover their contributions.⁵³

19. The Commission emphasized in the Universal Service Order, however, that to the extent that carriers pass all or part of their contributions on to their customers on customer bills, carriers should include complete and truthful information regarding the contribution amount.⁵⁴ Such carriers, the Commission made clear, "must be careful to convey information in a manner that does not mislead by omitting important information that indicates that the contributor has chosen to pass through the contribution or part of the contribution to its customers and that accurately describes the nature of the charge."⁵⁵ The Commission noted that, unlike the subscriber line charge, the universal service contribution is not a federally mandated direct end-user surcharge.⁵⁶ The Commission observed that it would be misleading for a carrier to characterize its contribution as a surcharge, because carriers retain the flexibility to structure their recovery of the costs of universal service in many ways, including creating new pricing plans subject to monthly fees.⁵⁷ The Commission also pointed out that, as competition intensifies in the markets for local and interexchange services, it will likely lessen the ability of carriers and other providers of telecommunications to increase rates to customers.⁵⁸

20. We recognize that, in the near term, consumers' bills will undergo some change as companies adjust to the pro-competitive mandates of the Act. The Commission anticipates that consumers should benefit from these adjustments in that rates should continue to fall, all Americans will continue to have affordable access to telephone service, and the costs of providing telephone service will be recovered in a manner that is more straightforward than that used in the monopoly era. We continue to be concerned that carriers provide clear and accurate information to subscribers. We intend to seek comment on the extent to which carriers that pass on to their customers all or part of their universal service contribution obligation are not including complete

⁵³ Id. The Commission stated: "[A]s telecommunications carriers and providers begin merging telecommunications products into single offerings, for example package prices for local and long distance service, we anticipate that they will offer bundled services and new pricing options. Mandating recovery through an end-user surcharge would eliminate carriers' pricing flexibility to the detriment of consumers." Id.

⁵⁴ Id. at 9211-12, ¶ 855.

⁵⁵ Id.

⁵⁶ Id.

⁵⁷ Id.

⁵⁸ Id. at 9211-12, ¶ 855.

and truthful information regarding the contribution amount. We will also seek comment on actions the Commission may take to reduce any confusion that consumers may experience with regard to universal service surcharges on their bills.

21. Revenue Base. The Commission also explained in the Universal Service Order that contributions to fund the schools and libraries support mechanism would be based on both interstate as well as intrastate revenues, consistent with the provisions of section 254(d).⁵⁹ More recently, in the Report to Congress submitted by the Commission on April 10, 1998, we examined certain Commission decisions regarding the revenue base on which contributors' universal service contributions are assessed.⁶⁰ After analyzing the Commission's conclusions regarding the jurisdictional parameters placed on the Commission and on states, we concluded that we have the authority to assess universal service contributions on telecommunications providers' interstate and intrastate revenues. The April 10th Report concluded that the Commission's decision to base contributions to the high cost and low-income support mechanisms solely on interstate revenues and to base contributions to the schools, libraries, and rural health care support mechanisms on intrastate and interstate revenues was consistent with section 254 of the Act. For convenience, we append the relevant portions of the April 10th Report, as Attachment A hereto.

22. Contributions for Schools and Libraries. As reflected in the May 8, 1998 letter from USAC, appended hereto as Attachment B, we estimate that approximately \$619 million will be available for use to fund the schools and libraries support mechanism through the end of the second quarter of 1998.⁶¹ Also reflected in Attachment B, the following represent the total estimated contributions for each category of contributors for the first and second quarters of 1998 that will be available to fund the schools and libraries support mechanism for the second quarter of 1998: (i) incumbent local exchange carriers will contribute approximately \$179 million; (ii) interexchange carriers will directly contribute approximately \$266 million;⁶² (iii) information

⁵⁹ Section 254(d) provides in pertinent part: "[E]very telecommunications carrier that provides interstate telecommunications services shall contribute, on an equitable and nondiscriminatory basis, to the specific, predictable, and sufficient mechanisms established by the Commission to preserve and advance universal service. . ." 47 U.S.C. § 254(d).

⁶⁰ Federal-State Joint Board on Universal Service, Report to Congress, CC Docket No. 96-45, FCC 98-67 (rel. April 10, 1998) (April 10th Report).

⁶¹ Letter from Universal Service Administrative Company to Chairman William E. Kennard, FCC, dated May 8, 1998, appended hereto as Attachment B.

⁶² This amount does not reflect the full extent of interexchange carriers' contributions to universal service support. Incumbent local exchange carriers pass through a portion of their universal service contribution obligation in the access charges they receive from interexchange carriers.

service providers, which are not obligated by the statute to contribute, will make no direct contribution; information service providers, however, will contribute significant amounts indirectly, as high-volume purchasers of telecommunications, as explained in the Commission's April 10th Report;⁶³ (iv) commercial mobile radio service providers will contribute approximately \$87 million; and (v) other providers (e.g., competitive local exchange providers, private carriers) will contribute approximately \$92.5 million.

B. Disbursements for Schools and Libraries Support.

23. Pursuant to Congress' mandate to establish adequate funding for the schools and libraries support mechanism, the Commission in the Universal Service Order set an annual cap for schools and libraries funding, basing its decision on the recommendations of the Joint Board and a record consisting of more than 100,000 pages of comments, expert testimony, and other submissions.⁶⁴ Because of the effective administration of the support mechanism, and the public's corresponding interest, the schools and libraries support will likely reach thousands of schools and libraries, and thereby offer meaningful, vital access to these communities. Indeed, the response and interest in the schools and libraries support mechanism attests to its tremendous success. During the initial 75-day window for filing applications, more than 30,000 completed applications were received from schools and libraries in every state in the union.⁶⁵ As of May 1, 1998, SLC

⁶³ April 10th Report at ¶¶ 66-72. In comments filed in connection with the April 10, 1998 Report to Congress on Universal Service, America Online reported that it expects to spend approximately \$1.2 billion for telecommunications services in fiscal 1999. The prices that it pays for those services incorporate universal service contributions. See *id.* at n. 130. America Online also estimates that Internet and online service production and consumption has generated roughly between \$10 billion and \$28 billion of incremental telecommunications services between 1990 and 1997, with incremental revenues in 1998 likely to be approximately between \$6 billion and \$17 billion. See Letter from George Vradenberg, III, America Online, to Chairman William E. Kennard, FCC, dated May 6, 1998 (citing MacKie-Mason, *Quantifying the Contribution: Estimates of Telecommunications Services Expenditures Attributable to Online Service Production and Consumption* (May 1998)).

⁶⁴ Universal Service Order, 12 FCC Rcd at 9054, ¶ 529. In addition to setting the annual cap, the Commission has imposed reasonable limitations on the types of discounted services that eligible schools, libraries, and rural health care providers may receive. Indeed, a significant portion of the costs of connecting schools comes from computers, software, and teacher training. These costs are not supported by universal service. Universal service support provides discounts only for telecommunications services, Internet access, and internal connections. In this way, the Commission's plan augments, not duplicates, the present efforts by states and localities to bring the information superhighway to America's classrooms and libraries.

⁶⁵ Third Quarter 1998 Fund Size Requirements for the Schools and Libraries Universal Service Program, dated May 1, 1998, at 2, appended hereto as Attachment C.

projected that \$2.02 billion in discounts have been requested by applicants who have filed through April 28, 1998.⁶⁶

24. The Senate bill directs three specific inquiries concerning disbursements for schools and libraries support. First, an estimate is requested of the costs of providing schools and libraries support, based on the applications for funding received as of April 15, disaggregated by the eligible services and facilities.⁶⁷ Second, a justification is sought of the amount, if any, by which the total requested disbursements from the fund may exceed the amount of available contributions for the second quarter.⁶⁸ Finally, an estimate is requested for the amount of contributions that will be required for the program in the third and fourth quarters of 1998.⁶⁹

25. In response, the costs, disaggregated by eligible services and facilities are reflected in SLC's May 7, 1998 letter appended hereto as Attachment D.⁷⁰ Although the total requested disbursements from the fund described above exceed the amount of available contributions

⁶⁶ Id.

⁶⁷ Section 2005(b)(3)(D) of the Senate bill requests: "[B]ased on the applications for funding under section 254(h) of the Communications Act of 1934 (47 U.S.C. 254(h)) received as of April 15, 1998, an estimate of the costs of providing universal service support to schools and libraries under that section disaggregated by eligible services and facilities as set forth in the eligibility list of the Schools and Libraries Corporation, including -- (i) the amounts requested for costs associated with telecommunications services; (ii) the amounts requested for costs described in clause (i) plus the costs of internal connections under the program; and (iii) the amounts requested for the costs described in clause (ii), plus the cost of internet access; (iv) the amount requested by eligible schools and libraries in each category and discount level listed in the matrix appearing at paragraph 520 of the Commission's May 8, 1997 Order, calculated as dollar figures and as percentages of the total of all requests: (I) the amount requested by eligible schools and libraries in each such category and discount level to provide telecommunications services; (II) the amount requested by eligible schools and libraries in each such category and discount level to provide internal connections; and (III) the amount requested by eligible schools and libraries in each such category and discount level to provide internet access."

⁶⁸ Section 2005(b)(3)(E) of the Senate bill requests: "[A] justification for the amount, if any, by which the total requested disbursements from the fund described in subparagraph (D) exceeds the amount of available contributions described in subparagraph (B)."

⁶⁹ Section 2005(b)(3)(F) of the Senate bill requests: "[B]ased on the amount described in subparagraph (D), an estimate of the amount of contributions that will be required for the schools and libraries program in the third and fourth quarters of 1998, and, to the extent these estimated contributions for the third and fourth quarter exceed the current second-quarter contribution, the Commission shall provide an estimate of the amount of support that will be needed for each of the eligible services and facilities as set forth in the eligibility list of the Schools and Libraries Corporation, and disaggregated as specified in subparagraph (D)."

⁷⁰ Letter from Schools and Libraries Corporation to Chairman William E. Kennard, FCC, dated May 7, 1998, appended hereto as Attachment D.

described in Attachment B, the explanation for this difference is that the disbursements reflect the amount requested for a twelve month period, while the contributions reported cover only a six month period. The contributions required in the third and fourth quarter will be determined after soliciting public comment in public notices that will be released early next week. In particular, we intend to seek comment on whether the amount collected for universal service support for schools and libraries in 1998 should equal the demand reported by SLC or be limited to an amount that does not cause long distance rates to increase.

C. Access Charge Reductions.

26. The Senate bill also seeks information relating to access charges. Specifically, it directs that an "estimate of the expected reductions in interstate access charges anticipated on July 1, 1998"⁷¹ be provided, as well as "an explanation as to whether access charge reductions should be passed through on a dollar-for-dollar basis to each customer class on a proportionate basis."⁷² Although the local exchange carriers will not file their access tariffs until June 16, 1998, based on preliminary information provided by the local exchange carriers, we estimate that the July 1, 1998 access charge reductions will be approximately \$700 million below current levels. Given this projected access charge reduction, we estimate that the quarterly collection rate for schools and libraries could rise from \$325 million (the second quarter collection rate) to approximately \$524 million⁷³ without increasing total access and universal service payments by long distance carriers. Accordingly, schools and libraries could be funded at approximately \$1.67 billion for the 1998 calendar year without increasing total access and universal service payment by long distance carriers.

27. In January 1998, the Commission began the process of removing funding for universal service from access charges. Instead of this implicit funding, we began funding universal service through explicit contributions from a broader array of telecommunications providers. In addition, in January 1998, the Commission implemented access charge reductions, and began

⁷¹ Section 2005(b)(3)(A).

⁷² Section 2005(b)(3)(H).

⁷³ We reach this result in the following manner. Long distance carriers pay direct contributions to universal service and, through interstate access charges, indirectly pay for most of the local exchange carrier contributions. Directly and indirectly, long distance carriers are responsible for approximately 82.5 percent of schools and libraries and rural health care contributions. Multiplying \$700 million by 1/.825 yields \$848 million. We divide \$848 million by 4 to find the incremental amount available for each quarter, which is \$212 million. We then add \$212 million to the average quarterly collection rate for the first half of 1998, \$312 million (the average of \$300 and \$325 million). Accordingly, access charge reductions of \$700 million yield \$524 million as a quarterly collection rate for the third and fourth quarters of 1998.

collection of contributions for the schools and libraries and rural health care mechanisms. We have found that changes in universal service support that were implemented January 1, 1998 did not increase the overall costs of long-distance carriers or the costs that local telephone companies need to collect in local rates.⁷⁴ For CMRS customers, we are finding that consumers have been seeing, and are continuing to see, significant reductions in prices even though the 1996 Act required for the first time that wireless carriers contribute to the support of universal service.⁷⁵

28. Access charges have been a significant portion of the total cost of providing long-distance service for all facilities-based long distance carriers. The Commission has previously found that the interstate long distance market is substantially competitive.⁷⁶ Because past experience indicates that long distance carriers tend to compete on the basis of per-minute rates, among other things, this competition creates strong incentives for carriers to reflect reductions in their costs through lower rates. Therefore, we would expect long distance companies to pass through access charge reductions, and especially reductions in per-minute access charges, to their customers.⁷⁷

⁷⁴ See Letter from Chairman William E. Kennard, FCC, to the Honorable Thomas J. Bliley, Chairman, Committee on Commerce, U.S. House of Representatives, dated May 7, 1998 at Attachment, "Changes in Interstate Interexchange Carrier Costs Occuring on January 1, 1998." (Letter and attachment appended hereto as Attachment E).

⁷⁵ See Letter from Chairman William E. Kennard, FCC, to the Honorable Thomas J. Bliley, Chairman, Committee on Commerce, U.S. House of Representatives dated May 7, 1998 (Attachment E).

⁷⁶ See, e.g., Policy and Rules Concerning the Interstate, Interexchange Marketplace; Implementation of Section 254(g) of the Communications Act of 1934, as amended CC Docket No. 96-61, Second Report and Order, 11 FCC Rcd 20730, 20733, 20742-43 (1996) (Interexchange Second Report and Order), stay granted, MCI Telecommunications Corp. v. FCC, No. 96-1459 (D.C. Cir. Feb. 13, 1997), Order on Reconsideration, 12 FCC Rcd 15014 (1997), further recon. pending; Motion of AT&T to be Reclassified as a Nondominant Carrier, Order, 11 FCC Rcd 3271, 3278-79, 3288 (1995) (AT&T Reclassification Order), Order on Reconsideration, Order Denying Petition for Rulemaking, Second Order on Reconsideration in CC Docket No. 96-61, 12 FCC Rcd 20787 (1997); Competition in the Interstate, Interexchange Marketplace, CC Docket No. 90-132, Report and Order, 6 FCC Rcd 5880, 5887 (1991), Order, 6 FCC Rcd 7255, Memorandum Opinion and Order, 7 FCC Rcd 2677 (1992), Memorandum Opinion and Order on Reconsideration, 8 FCC Rcd 2659 (1993), Second Report and Order, 8 FCC Rcd 3668 (1993), Memorandum Opinion and Order, 8 FCC Rcd 5046 (1993), Memorandum Opinion and Order on Reconsideration, 10 FCC Rcd 4562 (1995).

⁷⁷ Chairman Kennard has expressed his commitment to ensuring pass-through to residential as well as business customers. Toward that end, the Chairman recently requested explanations from long distance carriers of how their reduction in access charges were passed through to customers. See Letter from Chairman William E. Kennard, FCC, to Michael C. Armstrong, AT&T, dated February 26, 1998; Letter from Chairman William E. Kennard, FCC, to Bert Roberts, MCI, dated February 26, 1998; Letter from Chairman William E. Kennard, FCC, to William T. Esrey, Sprint, dated February 26, 1998. We are continuing our analysis of interstate long-distance rates to determine whether long-distance carrier rates have fully reflected the access charge reductions this

CONCLUSION

29. The interest in and success of the schools and libraries and rural health care support mechanisms to date attests to Congress' vision in extending universal service support to these important missions. This Report responds to the directives of the Senate bill. It proposes a revised structure for the administration of schools and libraries and rural health care support, and additionally provides documentation of the funding and disbursements for the schools and libraries mechanism, in particular. As described above, this Report seeks Congress' support and continuing partnership in discharging our obligations under the Act, and bringing the full benefits of a free and open telecommunications marketplace to all Americans.

FEDERAL COMMUNICATIONS COMMISSION

Magalie Roman Salas
Secretary

Commission ordered to take effect on that date.

ATTACHMENT A

Excerpt from Federal-State Joint Board on Universal
Service, Report to Congress, CC Docket No. 96-45,
FCC 98-67 (rel. April 10, 1998)

section 254(h)(1)(A) requires that a health care provider must be located in a rural area in order for its provider of telecommunications services to be eligible for universal service support.⁴⁵⁵ Again, however, the Commission did not rely on section 254(h)(1)(A) to authorize support for toll-free Internet access; rather, it relied on section 254(h)(2)(A).⁴⁵⁶ Whereas section 254(h)(1)(A) is concerned with the provision of service to "persons who reside in rural areas,"⁴⁵⁷ section 254(h)(2)(A), in contrast, seeks to enhance access to advanced services for "all . . . health care providers . . ."⁴⁵⁸ Section 254(h)(2)(A) is thus independent of section 254(h)(1)(A) and its limitations and, further, provides the broader authority to promulgate rules for the benefit of "all health care providers," not just rural ones. In our view, the Commission's decision to extend support for the provision of toll-free Internet access to non-rural health care providers is entirely consistent with this language.

VII. REVENUE BASE AND PERCENTAGE OF FEDERAL FUNDING

194. In this section, we examine first certain Commission decisions regarding the revenue base on which contributors' universal service contributions are assessed. After analyzing the Commission's conclusions regarding the jurisdictional parameters placed on the Commission and on the states, we agree that the Commission has the authority to assess universal service contributions on both telecommunications providers' interstate and intrastate revenues.

195. We examine, second, the Commission's previous decisions regarding the level of interstate high cost support. At the onset, we believe it is important to make two observations to place this issue in context. First, the discussion of the issue in this Report relates only to non-rural local exchange carriers. With respect to rural local exchange carriers, the Commission has determined that there shall be no change in the existing high cost support mechanisms until January 1, 2001 at the earliest. We do not revisit that determination in this Report. Thus, the method of determining federal support for rural local exchange carriers will remain unchanged until at least January 1, 2001, meaning that the amount of universal service support for rural local exchange carriers will be maintained initially at existing levels and then should increase in accordance with specified factors, such as inflation, that have historically guided changes in such support. Any possible change in the support mechanism for rural local exchange carriers would require a separate rulemaking proceeding.

196. Second, we note that the pre-May 8, 1997 regulatory scheme created a *de facto* allocation of responsibility between the Commission and state commissions with respect to support for service to rural and high cost areas. That allocation of responsibility

⁴⁵⁵ See *supra* at section VI.B.3.A.

⁴⁵⁶ See Universal Service Order , 12 FCC Rcd at 9157-9160, paras. 742-748; see note 434, *supra* .

⁴⁵⁷ 47 U.S.C. § 254(h)(1)(A).

⁴⁵⁸ 47 U.S.C. § 254(h)(2)(A) (emphasis added).

was defined by the separations rules, which placed 25 percent of booked loop costs in the interstate jurisdiction for most of the loop plant used by the non-rural LECs. In addition, the aggregate amount of LEC network investment in the interstate jurisdiction is approximately 25 percent. Through the operation of an explicit universal service support mechanism, however, greater than 25 percent of booked loop costs were placed in the interstate jurisdiction in those areas where loop costs were particularly high. As a result, some of the non-rural LECs did have slightly more than 25 percent of their booked loop costs in the interstate jurisdiction, and many rural LECs had substantially more than 25 percent in the federal jurisdiction.

197. As discussed below, we conclude that a strict, across-the-board rule that provides 25 percent of unseparated high cost support to the larger LECs might provide some states with less total interstate universal service support than is currently provided through aggregate implicit and explicit federal subsidies. The Commission will work to ensure that states do not receive less funding as we implement the high cost mechanisms under the 1996 Act. We find that no state should receive less federal high cost assistance than it currently receives. We are mindful that the Commission's work in this regard is not yet complete. We are committed to issuing a reconsideration order in response to the petitions filed asking the Commission to reconsider the decision to fund 25 percent of the required support amount. In the course of that reconsideration, we will take all appropriate steps, including continued consultation with the states, to ensure that federal funding is adequate to achieve statutory goals. We also recognize that Congress assigned to the Commission, after consultation with the Joint Board, the ultimate responsibility for establishing policies that ensure that: 1) quality services are available at just, reasonable and affordable rates; 2) all consumers have "access to telecommunications and information services" at rates that are reasonably comparable to the rates charged for similar services in urban areas; and 3) there are "specific, predictable, and sufficient" federal and state mechanisms to preserve and advance universal service. We are committed to implementing section 254 consistent with these objectives.

A. Revenue Base for Contributions

1. Background

198. Section 623(b)(5) of the Appropriations Act requires the Commission to review its "decisions regarding the percentage of universal service support provided by federal mechanisms and the revenue base from which such support is derived." This requirement implicates several important determinations made by the Commission, including what is referred to as the "25/75" approach to sharing responsibility for universal service support between the state and federal jurisdictions. In addition, we must address Commission decisions regarding: the scope of the Commission's jurisdiction in assessing and recovering contributions; the scope of the revenue base for, and the method of recovery of, contributions to the support mechanisms for high cost areas and low income consumers and for eligible schools, libraries, and rural health care providers; and the methodology for assessing contributions to the support mechanisms. We review each of these issues below.

199. In the Universal Service Order , the Commission analyzed the scope of the Commission's jurisdiction with respect to the assessment and recovery of universal service support mechanisms.⁴⁵⁹ The Commission concluded that it has jurisdiction to assess contributions for the universal service support mechanisms from intrastate as well as interstate revenues and to require carriers to seek state (and not federal) authority to recover a portion of the contribution in intrastate rates.⁴⁶⁰ The Commission expressly declined to exercise the entirety of its jurisdiction with respect to the assessment and recovery of contributions to the universal service mechanisms for rural, insular, and high cost areas, and low income consumers.⁴⁶¹ Instead, the Commission assessed contributions to those mechanisms based solely on interstate revenues.⁴⁶² With respect to the recovery of those contributions, the Commission continued its historical approach to recovery of universal service support mechanisms, thereby permitting carriers to recover contributions to these universal service support mechanisms through rates for interstate services only.⁴⁶³

200. With respect to the universal service support mechanisms for schools and libraries and rural health care providers, the Commission adopted the Joint Board's recommendation that these mechanisms be funded by contributions based on both the intrastate and interstate revenues of providers of interstate telecommunications services.⁴⁶⁴ The Commission concluded, however, that it will permit recovery of the entirety of these contributions solely via rates for interstate services for the present time.⁴⁶⁵

201. In the Universal Service Order , the Commission concluded that, beginning January 1, 1999, the federal universal service mechanism for large local exchange carriers serving rural, insular, and high cost areas will support 25 percent of the difference between the forward-looking economic cost of providing the supported service and the revenue benchmark.⁴⁶⁶ After considering various methodologies for calculating contributions to the universal service mechanism, the Commission determined that carriers should calculate contributions to the universal service mechanisms using end-user telecommunications revenues.⁴⁶⁷

⁴⁵⁹ Universal Service Order , 12 FCC Rcd at 9192, paras. 813-823.

⁴⁶⁰ Id. at 9192, para. 813.

⁴⁶¹ Id. at 9192, para. 813.

⁴⁶² Id. at 9200, para. 831.

⁴⁶³ Id. at 9198, para. 825.

⁴⁶⁴ Id. at 9203, para. 837.

⁴⁶⁵ Id. at 9203, paras. 837-838.

⁴⁶⁶ Id. at 9201, para. 833.

⁴⁶⁷ Id. at 9205-06, para. 842-843.

2. Discussion

a. Commission Authority With Respect to the Assessment and Recovery of Contributions to Universal Service Support Mechanisms

202. In the Universal Service Order , the Commission determined that Section 254 provides the Commission with the jurisdiction to assess contributions for universal service support mechanisms from both interstate and intrastate revenues, as well as to require carriers to seek authority from states to recover a portion of the contribution in intrastate rates.⁴⁶⁸ Some parties argue that the Commission's decisions overstep the traditional relationship between the federal and state jurisdictions.⁴⁶⁹ Other commenters argue that the Commission should exercise its full authority to assess contributions for high cost support mechanisms on both intrastate and interstate revenues.⁴⁷⁰ Our review of the issue for purposes of this Report, however, leads us to the conclusion that the Commission's jurisdictional analysis in the Universal Service Order is sound.

203. As the Commission stated in the Universal Service Order , the Commission's authority over universal service support mechanisms stems from the plain language of section 254.⁴⁷¹ Specifically, although the statute contemplates the establishment of federal and state high cost support mechanisms that are consistent with the objectives of section 254, that section imposes on the Commission the ultimate responsibility to implement the universal service mandate of section 254.⁴⁷² Section 254(c)(1) likewise authorizes the Commission to define the parameters of universal service.⁴⁷³ Moreover, section 254(b)(5) anticipates that the Commission will establish support mechanisms that are "specific, predictable and sufficient."⁴⁷⁴ These provisions indicate that the Commission has the primary responsibility and authority to ensure that universal service mechanisms are "specific, predictable, and sufficient" to meet the statutory principle of "just, reasonable, and affordable rates." This interpretation is complementary to the states' independent obligations to ensure that support mechanisms are "specific, predictable, and sufficient" and

⁴⁶⁸ Id. at 9197, para. 823.

⁴⁶⁹ See, e.g., Iowa comments at 3; Nevada PUC comments at 3-8. This issue has also been raised on appeal. See Brief of Petitioner Cincinnati Bell Tel. Co., *Texas Office of Pub. Util. Counsel v. FCC* , No. 97-60421 (5th Cir.) at 11-25.

⁴⁷⁰ See, e.g., GTE comments at 29; JSI comments at 6; RTC comments at 5-6.

⁴⁷¹ Universal Service Order , 12 FCC Rcd at 9192, para. 814.

⁴⁷² Section 254(a) provides that rules "to implement" the section are to be recommended by the Joint Board and those recommendations are to be implemented by the Commission. 47 U.S.C. § 254(a).

⁴⁷³ Section 254(c)(1) directs that the concept of universal service is an "evolving level of telecommunications that the Commission shall establish periodically." 47 U.S.C. § 254(c)(1).

⁴⁷⁴ 47 U.S.C. § 254(b)(5).

that rates are "just, reasonable, and affordable," because the statute provides that state universal service mechanisms must be consistent with, and may not conflict with, the federal mechanisms.⁴⁷⁵

204. The Commission's conclusion regarding the scope of its jurisdiction is also supported by several provisions of section 254 that indicate that Congress intended universal service support mechanisms to include both intrastate and interstate services. Specifically, section 254(b)(3) establishes that the Commission's rules and policies must ensure that "consumers in all regions of the Nation . . . have access to telecommunications and information services."⁴⁷⁶ This language supports a finding that universal service should include more than access to interstate services, which previously has generally been the focus of federal telecommunications law. Moreover, because the traditional core goal of universal service is ensuring affordable basic residential telephone service, which is primarily an intrastate service, it is clear that section 254(b)'s goal of affordable basic service indicates that Congress intended that both intrastate and interstate services should be affordable. It is significant that the Joint Board agreed with this conclusion by recommending that the services eligible for universal service support pursuant to section 254(c) include intrastate services.⁴⁷⁷

205. As the Commission concluded in the Universal Service Order, the ability of states to create separate support mechanisms covering intrastate carriers pursuant to section 254(f) does not suggest that the amount of a carrier's contributions to such a support mechanism should be based on the type of telecommunications service, intrastate or interstate, provided by the carrier.⁴⁷⁸ We find no support for such an inference in the legislative history. Rather, the legislative history indicates that states continue to have jurisdiction over implementing universal service mechanisms for intrastate services supplemental to the federal mechanisms as long as "the level of universal service provided by each state meets the minimum definition of universal service established [under section 254] and a State does not take any action inconsistent with the obligation for all telecommunications carriers to contribute to the preservation and advancement of universal service" established under section 254.⁴⁷⁹

206. Similarly, section 2(b), which provides that nothing in the Act should be construed to give the Commission jurisdiction with respect to "charges, classifications, practices, services, facilities, or regulations for or in connection with intrastate communications services by wire or radio," does not preclude the Commission from

⁴⁷⁵ See 47 U.S.C. §§ 254(b)(5) & (f).

⁴⁷⁶ 47 U.S.C. § 254(b)(3).

⁴⁷⁷ Recommended Decision, 12 FCC Rcd at 112, para. 46.

⁴⁷⁸ Universal Service Order, 12 FCC Rcd at 9195, para. 819.

⁴⁷⁹ Joint Explanatory Statement at 128.

assessing contributions based on a percentage of a carrier's intrastate revenues.⁴⁸⁰ Determining such contributions for universal service support on intrastate, as well as interstate, revenues constitutes neither rate regulation of those services nor regulation of those services in violation of section 2(b). Rather, this method of assessment supports intrastate services, as expressly required by section 254 of the Act and as recommended by the Joint Board. Indeed, in assessing contributions in this way, the Commission is calculating a federal charge based on both interstate and intrastate revenues, but is in no way regulating the rates and conditions of intrastate service.

207. Further, section 254's express directive that universal service mechanisms be "sufficient" ameliorates any section 2(b) concerns. As a rule of statutory construction, section 2(b) only is implicated where the competing statutory provision is ambiguous.⁴⁸¹ As discussed above, section 254 unambiguously establishes that the services to be supported have intrastate as well as interstate characteristics and permits the Commission to establish regulations implementing federal support mechanisms for the supported intrastate services.

208. Moreover, various provisions of section 254, some of which are discussed above, have blurred the traditional distinction between the interstate and intrastate jurisdictional spheres. For example, although section 254 establishes a federal-state partnership, it grants the Commission primary responsibility for defining the parameters of universal service, and for ensuring that universal service mechanisms are "specific, predictable, and sufficient" to meet the statutory goal of "just, reasonable, and affordable rates." Indeed, section 254 envisions that the Commission would not be bound by the prior system of universal service mechanisms, which was based on the traditional jurisdictional spheres.⁴⁸²

209. For all of the foregoing reasons, we concur with the Commission's earlier conclusion that section 254 of the 1996 Act grants the Commission the authority to assess contributions to universal service support mechanisms from intrastate as well as interstate revenues and to refer carriers to seek state (and not federal) authorization to recover a portion of the contribution in intrastate rates, although the Commission has not exercised this authority. We note that this issue is the subject of pending petitions for reconsideration which we will address in a forthcoming order. Further, we have previously expressed willingness to work with states and we affirm that commitment.⁴⁸³

⁴⁸⁰ 47 U.S.C. § 152(b).

⁴⁸¹ See Universal Service Order , 12 FCC Rcd at 9196, para. 822 n.2094 citing 47 U.S.C. § 601.

⁴⁸² See Joint Explanatory Statement at 131 (indicating against reliance on current methodologies by stating that support mechanisms should be "explicit, rather than implicit as many support mechanisms are today."); Senate Report on S. 652 (stating that "the bill does not presume that any particular existing mechanism for universal service support must be maintained or discontinued").

⁴⁸³ See, eg. Universal Service Order , 12 FCC Rcd at 9191, para. 809.

b. Revenue Base For, and Recovery of, Contributions to Support Mechanisms for Eligible Schools, Libraries and Rural Health Care Providers

210. Initially, we note that few parties commented on the issues of the assessment and recovery of contributions to the support mechanism for eligible schools, libraries and rural health care providers.⁴⁸⁴ After consideration of these important issues, we conclude that the Commission's decisions are consistent with the letter and spirit of the 1996 Act.

211. Assessment. With respect to the assessment of contributions, we conclude it was reasonable for the Commission to adopt the Joint Board's recommendation that "universal support mechanisms for schools and libraries and rural health care providers be funded by contributions based on both the intrastate and interstate revenues of providers of interstate telecommunications services."⁴⁸⁵ As the Commission concluded in the Universal Service Order, this approach is reasonable in light of the fact that the schools, libraries, and rural health care mechanisms are "new, unique support mechanisms that have not historically been supported through a universal service funding mechanism."⁴⁸⁶

212. Recovery. Similarly, we reaffirm the Commission's decision to permit carriers to recover contributions for the support mechanisms for eligible schools, libraries, and rural health care providers solely via rates for interstate services.⁴⁸⁷ Limiting recovery to the interstate jurisdiction for the support mechanism for the schools, libraries and rural health care providers will ameliorate the concern that carriers would recover the portion of their intrastate contributions attributable to intrastate services through increases in rates for basic residential dialtone service. The Commission's approach is consistent with the affordability principle contained in section 254(b)(1).⁴⁸⁸ Additionally, we are persuaded that the Commission's approach minimizes any perceived jurisdictional difficulties under section 2(b) because carriers are not required to seek state authorizations to recover contributions attributable to intrastate revenues.⁴⁸⁹ Therefore, we find that permitting recovery of contributions for the support mechanisms for eligible schools, libraries, and rural health care providers solely via rates for interstate services is consistent with section 254.⁴⁹⁰

⁴⁸⁴ TDS comments at 10 (supporting the decision to use total, unseparated interstate and intrastate end user revenues as the basis for support contributions designed to benefit schools, libraries and rural health care providers).

⁴⁸⁵ Universal Service Order, 12 FCC Rcd at 9203, para. 837 citing Recommended Decision, 12 FCC Rcd at 499, para. 817.

⁴⁸⁶ Id. at 9203, para. 837.

⁴⁸⁷ Id. at 9203, para. 838.

⁴⁸⁸ Id. at 9203, para. 838.

⁴⁸⁹ Id. at 9204, para. 839.

⁴⁹⁰ Id. at 9203-9204, paras. 838-840.

c. Revenue Base For, and Recovery of, Contributions to Support Mechanisms for High Cost Areas and Low Income Consumers

213. Assessment. As stated above, the Commission declined to exercise its authority to assess contributions to the high cost and low income support mechanisms on both intrastate and interstate revenues. Instead, the Commission elected to base those contributions solely on interstate revenues.⁴⁹¹ We find that the Commission's decision was reasonable and appropriate in light of the statutory goals.

214. In its Recommended Decision, the Joint Board concluded that the "decision as to whether intrastate revenues should be used to support the high cost and low income assistance programs should be coordinated with the establishment of the scope and magnitude of the proxy-based fund, as well as with state universal service support mechanisms."⁴⁹² Thus, the Joint Board did not submit a recommendation as to whether intrastate revenues should be used to support the high cost and low income mechanisms.⁴⁹³ Rather, as the Commission noted in the Universal Service Order, the Joint Board's analysis essentially concluded that the determination of whether contributions should be based on intrastate as well as interstate revenues should be coordinated with the implementation of an appropriate forward-looking economic cost mechanism and revenue benchmark.⁴⁹⁴ Because the mechanism and benchmark were not established, and therefore, the total amount of support requirement was unknown, it would have been premature for the Commission to assess contributions on intrastate as well as interstate revenues.

215. In addition, shortly before the Universal Service Order was issued, the state members of the Joint Board filed a report in which the majority recommended that the Commission assess contributions for all support mechanisms on intrastate and interstate revenues.⁴⁹⁵ The majority report also supported the Commission's approach to assessing only interstate revenues for the high cost and low income support mechanisms on an interim basis until a forward-looking economic cost methodology is developed.⁴⁹⁶ Accordingly, the Commission's decision to base contributions to the high cost and low-income support mechanisms solely on interstate revenues was consistent with the Majority State Members' report.

⁴⁹¹ Id. at 9200, para. 831.

⁴⁹² Recommended Decision, 12 FCC Rcd at 499, para. 817.

⁴⁹³ Universal Service Order, 12 FCC Rcd at 9198, para 824.

⁴⁹⁴ Id. at 9200, para. 832 citing Recommended Decision, 12 FCC Rcd at 501, para. 821.

⁴⁹⁵ Majority Opinion of the State Members of the Joint Board on the Funding of Universal Service, filed April 23, 1997 ("Majority State Members' Report").

⁴⁹⁶ Majority State Members' Report.

216. Indeed, by declining to base those contributions on intrastate revenues, the Commission promoted comity between the federal and state regulators, and allowed the state commissions to continue to work together to reach consensus on this issue. Because we are still in the process of adopting a forward-looking economic cost mechanism and a revenue benchmark, we conclude that assessing contributions on interstate revenues alone, at least until a unified federal-state approach is developed for the high cost and low-income support mechanisms, is consistent with the public interest.

217. We note that some commenters raise related issues on which the Commission continues to deliberate. For example, members of the wireless industry are concerned about the difficulty of distinguishing their interstate revenues from their intrastate revenues, given the mobile nature of wireless technologies, the inability to determine precisely the point of origin of calls, and the difficulty of matching phone numbers with points of origin.⁴⁹⁷ Wireless carriers have also raised issues regarding revenue reporting requirements,⁴⁹⁸ including issues perceived to be particular to their industry concerning itemizing roaming revenues, special resale issues, bundled offerings, and fraud-related uncollectibles.⁴⁹⁹ We also note that wireless providers have challenged state decisions that they should be subject to state universal service mechanisms.⁵⁰⁰ These are difficult issues, and we are committed to working with the wireless industry and the state commissions to resolve these issues.⁵⁰¹

218. Recovery. For similar reasons, we conclude that it is appropriate to allow carriers to recover contributions to the support mechanisms for high cost areas and low-income consumers through rates for interstate services only. The Joint Board concluded that the "role of complementary state and federal universal service mechanisms require[d] further reflection," but did not address the issue of the recovery of these contributions. Accordingly, we reaffirm the conclusion that this approach to recovery promotes comity between the federal and state governments because it allows the Commission and the states to develop compatible universal service mechanisms. This approach also promotes the statutory goal of affordable basic residential service because it avoids a blanket increase in charges for basic residential dialtone service. We find that it is reasonable and in the public interest to maintain, for the present time, the historical approach to recovering universal service support contributions for high cost areas and low-income consumers. We note,

⁴⁹⁷ See, e.g., Comcast comments at 10-11; CTIA comments at 2-3; PCIA comments at 14; Vanguard comments at 6; Nextel reply comments at 5.

⁴⁹⁸ Some wireless providers are concerned that the Commission's "good faith" estimation process will result in competitive inequities. See, e.g., Comcast comments at 11-15; CTIA comments at 3; Comcast reply comments at 7. See also Order on Reconsideration, Second Report and Order, and Further Notice of Proposed Rulemaking, CC Docket No. 97-21 and No. 96-45 at para. 21 (rel. August 15, 1997).

⁴⁹⁹ See, e.g., CTIA comments at 2; Comcast comments at 11-12; PCIA comments at 13-16.

⁵⁰⁰ See Cellular Telecommunications Industry Association v. FCC, et al., Case No. 97-160 and consolidated cases.

⁵⁰¹ We note that these issues are before the Commission on reconsideration and we do not wish to prejudge those petitions.

however, that the Commission concluded in its Fourth Order on Reconsideration that CMRS providers may recover their universal service contributions through rates charged for all services.⁵⁰² The Commission concluded that the reasons that generally warrant permitting contributors to recover contributions to the federal universal service mechanisms through rates on interstate services, such as ensuring the the continued affordability of residential dialtone services and promoting comity between the federal and state governments, do not apply to CMRS providers.⁵⁰³

B. Percentage of Federal Funding

219. As noted above, the Commission is responsible for ensuring that there are specific, predictable, and sufficient federal and state mechanisms to preserve and advance universal service. Upon further review, we conclude that a strict, across-the-board rule that provides 25 percent of unseparated high cost support to the larger LECs may have the result of withdrawing some federal explicit universal service support from some areas. The Commission will work to ensure that states do not receive less funding as we implement the high cost support mechanisms under the 1996 Act. We find that no state should receive less federal high cost assistance than it currently receives. We emphasize again that the following discussion concerns only non-rural local exchange carriers. High cost support for rural carriers will continue to be provided in accordance with the plan adopted in the Universal Service Order , which contemplates no changes earlier than January 1, 2001.

1. Background

220. Section 254(b)(5) establishes the principle that "[t]here should be specific, predictable and sufficient Federal and State mechanisms to preserve and advance universal service."⁵⁰⁴ Additionally, section 254(i) provides that "the Commission and the States should ensure that universal service is available at rates that are just, reasonable and affordable."⁵⁰⁵ The Commission has stated that section 254 continues the historical partnership between the federal and state jurisdictions in advancing and preserving universal service mechanisms.⁵⁰⁶ Similarly, the Joint Board stated in its Recommended Decision that

⁵⁰² Fourth Order on Reconsideration at para. 309.

⁵⁰³ Fourth Order on Reconsideration at para. 309 ("Because section 332(c)(3) of the Act alters the 'traditional' federal-state relationship with respect to CMRS by prohibiting states from regulating rates for intrastate commercial mobile services, allowing recovery through rates on intrastate as well as interstate CMRS services would not encroach on state prerogatives. Further, allowing recovery of universal service contributions through rates on all CMRS services will avoid conferring a competitive advantage on CMRS providers that offer more interstate than intrastate services.").

⁵⁰⁴ 47 U.S.C. § 254(b)(5).

⁵⁰⁵ 47 U.S.C. § 254(i).

⁵⁰⁶ Universal Service Order , 12 FCC Rcd at 9194, para. 818.

the 1996 Act "reflects the continued partnership among the states and the Commission in preserving and advancing universal service."⁵⁰⁷

221. The Commission, in its Universal Service Order, decided initially to fund 25 percent of the difference between a carrier's forward-looking economic cost of providing supported services and a revenue benchmark in order to approximate the portion of the cost of providing the supported network facilities that historically have been recovered by local telephone companies from their charges for interstate services.⁵⁰⁸ The current separations rules, which were developed through a Federal-State Joint Board process and have been in place since 1984, allocate 25 percent of loop costs to the federal jurisdiction and 75 percent to the states.⁵⁰⁹ Because local loop costs are likely to be the predominant cost that varies between high cost and non-high cost areas, the Commission determined, on a preliminary basis, that this factor approximated the interstate portion of universal service costs.⁵¹⁰ Consistent with the decisions to fund 25 percent of total universal service high cost support from the assessment and recovery from interstate revenue alone and to eliminate the special jurisdictional separations rules implementing the pre-1996 Act universal service mechanisms, the Commission also directed incumbent LECs in the companion Access Reform Order to use federal universal service support received under the new mechanisms to reduce interstate access charges. In that way, the Commission rendered explicit the universal service support formerly implicit in interstate access charges that has traditionally helped keep local rates affordable. In addition, the Commission decided to delay the transition to a universal service mechanism based on forward looking economic costs for rural LECs until no sooner than January 1, 2001.⁵¹¹ Until that time, eligible rural LECs will continue to receive support based on existing mechanisms.

222. This issue has generated extensive attention including a significant number of comments in this proceeding. Some commenters argue that the high cost universal service program should be 100 percent federally funded.⁵¹² In general, these parties contend that section 254(e) refers only to the federal responsibility for ensuring sufficient mechanisms, without imposing parallel state funding obligations.⁵¹³ Several parties argue that the discretionary language in section 254(f) permits, but does not compel, the states to choose

⁵⁰⁷ Id. at 9189, para. 806 citing Recommended Decision, 12 FCC Rcd at 500, para. 819.

⁵⁰⁸ Universal Service Order, 12 FCC Rcd at 8925, para. 269.

⁵⁰⁹ Id. at 8925, para. 270.

⁵¹⁰ Id. at 8926, para. 271.

⁵¹¹ Id. at 8889, paras. 203-204.

⁵¹² Alabama, Alaska, et. al comments at 4; Alaska comments at 11-15; Colorado PUC comments at 1-4; Local and State Gov't Advisory Committee comments at 2-3; USWEST comments at 6.

⁵¹³ 47 U.S.C. § 254(e).

ATTACHMENT B

USAC

UNIVERSAL SERVICE
ADMINISTRATIVE CO.

100 South Jefferson Road
Whippany, NJ 07981

Ed English, Secretary & Treasurer
(973) 884-8074 Fax: (973) 884-8262
E-mail: eenglis@neca.org

May 8, 1998

Chairman William E. Kennard
Federal Communications Commission
1919 M Street, N.W. - Room 802
Washington, D.C. 20554

Dear Chairman Kennard:

At the request of Commission staff, USAC is providing an accounting, as of April 21, 1998, of the total contributions to the universal service fund that are available for use to support the schools and libraries program for the second quarter of 1998, and an accounting of the amount of the contribution that USAC expects to receive from (i) incumbent local exchange carriers; (ii) interexchange carriers; (iii) information service providers; (iv) commercial mobile radio service providers; and (v) other providers.

Please contact me if you have any questions or if you require any additional information.

Sincerely,

Ed English

Attachment

ATTACHMENT A

FUNDS AVAILABLE FOR SECOND QUARTER 1998
FOR SCHOOLS & LIBRARIES SUPPORT MECHANISM

(amounts stated in thousands)

FUNDS AVAILABLE FROM 1Q98 S&L MECHANISM \$ 298,773 ¹

PROJECTED FUNDS AVAILABLE FOR 2Q98 S&L MECHANISM \$ 619,076 ¹

CONTRIBUTIONS TO SCHOOLS AND LIBRARIES BY CARRIER TYPE: ²

CXR Type ³		Jan 1998	Feb 1998	Mar 1998	Apr 1998	May 1998	June 1998
LEC	Collections	29,151	29,094	29,134			
	Projected Collections			146	30,469	30,469	30,469
IXC	Collections	43,179	43,057	40,899			
	Projected Collections			2,781	45,454	45,454	45,454
CMRS	Collections	14,120	14,120	14,066			
	Projected Collections			118	14,759	14,759	14,759
All Others	Collections	14,679	14,283	12,839			
	Projected Collections			2,574	16,052	16,052	16,052
	Total Collections:	101,129	100,554	96,938			
	Projected Collections:			5,619	106,734	106,734	106,734

NOTES:

- 1 - Adjusted for bankrupts, late payers, late charges, projected administrative expenses, and interest.
- 2 - Not adjusted for bankrupts, late payers, late charges, projected administrative expenses, and interest.
- 3 - Information Service Providers (ISPs) currently are not required to contribute directly to the Universal Service. The amount of ISPs indirect contribution is not specifically represented here.

ATTACHMENT C



SCHOOLS AND LIBRARIES
CORPORATION

1023 15th Street, N.W.
Suite 200
Washington, DC 20005
Phone: 202-289-2663
Fax: 202-289-7836

Ira Fishman
Chief Executive Officer

May 1, 1998

Honorable Magalie Roman Salas
Secretary
Federal Communications Commission
1919 M Street, NW
Washington, DC 20054

RE: Schools and Libraries Corporation
Fund Size Requirements for Third Quarter 1998
CC Docket Nos. 96-45, 97-21

Dear Secretary Salas:

In accordance with 47 C.F.R. § 54.709(a)(3), enclosed are the original and four (4) copies of the Third Quarter 1998 Fund Size Requirements for the Schools and Libraries Universal Service Program.

Acknowledgment and date of receipt of this letter is requested. A duplicate copy has been provided for that purpose.

Respectfully submitted,

Ira Fishman
Chief Executive Officer

Enclosure

Board of Directors

Kathleen "K. G." Ouye
Chair
Schools & Libraries
Corporation
City Librarian
San Mateo Public Library

Henry R. Marockie, Ed D
Vice Chair
Schools & Libraries Corporation
Council of Chief State School Officers
State Superintendent of Schools
West Virginia Department of Education

Kenneth D. Brody
Managing Partner
Winslow Partners, LLC

Anne L. Bryant
Executive Director
National Schools Boards
Association
(NSBA)

Ira Fishman
Chief Executive Officer
Schools & Libraries
Corporation

Frank J. Gumper
Vice President
Long Range Public Policy
Bell Atlantic

Brian L. Talbott, Ph.D.
Executive Director
American Association of
Educational Service Agencies
Superintendent Educational
Service District 101

**Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554**

**Schools and Libraries Fund
Fund Size Requirements for Third Quarter 1998
CC Docket Nos. 96-45, 97-21**

I. Introduction

The Schools and Libraries Corporation (SLC or Corporation) hereby submits this filing in accordance with section 54.709(a)(3) of the Federal Communications Commission's (FCC or Commission) rules.¹ This filing details fund size requirements for Third Quarter 1998 for the Schools and Libraries Fund.

II. Schools and Libraries Fund

The Commission's May 7, 1997, Universal Service Order² outlined a plan to ensure that all eligible schools, libraries³ and rural health care providers have affordable connections to the global telecommunications network. The plan created a fund to provide telecommunications services and to wire schools and libraries for access to the Internet. Pursuant to the Commission's rules,⁴ this fund is capped at \$2.25 billion per

¹47 C.F.R. § 54.709(a)(3).

² Federal-State Joint Board on Universal Service, CC Docket No. 96-45, *Report and Order*, 12 FCC Rcd 8776 (1997) (Universal Service Order).

³ The term "school" includes individual schools, school districts, and consortia of schools and/or school districts. The term "library" includes individual library branches, library facilities, library systems, and library consortia.

⁴See 47 C.F.R. § 54.507(a).

funding year. The Commission appointed the National Exchange Carrier Association (NECA) to temporarily administer, through an independent, non-profit subsidiary, billing and collection for support mechanisms which will fund the universal service programs. The Commission ordered NECA to incorporate an independent, non-profit subsidiary to perform these duties, Universal Service Administrative Company (USAC), and two, non-profit, unaffiliated corporations, the Schools and Libraries Corporation and the Rural Health Care Corporation (RHCC).

USAC will administer, temporarily, the universal service support mechanisms for high cost areas and low-income consumers, as well as billing, collection and disbursement functions for schools, libraries and rural health care providers. The SLC will provide all other functions for the schools and libraries program, such as administering the application process, creating and maintaining a Web Site to post services requested applications, and performing outreach and public education.

III. Projected Demand

The SLC has undertaken a statistically valid sampling of applications filed for the 1998 Funding Year in order to project the total amount of discounts requested in those applications. There is a 95 percent confidence level that the projection of total requests is within 5 percent of the actual total requests in the more than 30,000 applications that have been received. Based upon the analysis of this sample, we project that \$2.02 billion in discounts have been requested by applicants who have filed through April 28th.

IV. Estimates of SLC Expenses

A. Third Quarter 1998

In the Third Quarter of 1998, the SLC will begin processing the second round of applications -- for Funding Year 1999. Expenses for the SLC staff itself will be lower than the Second Quarter estimate because staffing remains below earlier budget projections. Start-up costs also will be lower as the largest initial phase of Web Site development and formulation of operating procedures will be completed in the Second Quarter. On the other hand, other contractor costs will be higher than the January Second Quarter estimate because the SLC will be processing both 1998 vendor invoices and 1999 funding applications.

There are some significant assumptions underlying our expense estimates.

They include the following:

- a total of about 50,000 FCC Forms 470 for 1999 funding filed in the Third Quarter, with 10 percent filed on paper,
- no significant volume of FCC Forms 471 processed in the Third Quarter,
- about 75,000 FCC Forms 486 and 500,000 invoices filed for Funding Year 1998, and
- the volume of calls to the Client Service Bureau is down from the Second Quarter due to a better informed client base and the availability of more detailed filing guidance.

With these assumptions, expenses and interest income for the Third Quarter 1998 are estimated as follows (amounts in millions):

3Q 1998 Expenses	\$4.2
Expenses from USAC	.2
Interest Income	<u>- 0⁵</u>
Total	<u>\$4.4</u>

⁵ Interest earned in the Third Quarter will depend on the size of collections and on the amount and rate of disbursements in July. Therefore, this represents a very conservative assumption.

As noted above, the SLC will be supporting two complete application cycles in 1998 – for Funding Years 1998 and 1999. The Web Site opened for applications for 1998 funding on January 30, 1998, and the 75-day window closed on April 15. Applications can continue to be filed after the close of the window, but we are seeing a significant decline in the volume of applications for 1998 funding since the close of the window. On July 1, 1998, we will begin receiving applications for funding for 1999. We expect to have funding commitments made before December 31, 1998 for 1999 funding requests for those who file within the first three to four months after July 1. Therefore, our Client Service Bureau will handle a new round of questions for 1999 later this year, as well as data entry for 1999 applications. Our Program Integrity Assurance unit is beginning pre-commitment review now of applications for 1998 funding and will begin review of applications for 1999 funding in the fall of 1998.

We have analyzed how our estimated Third Quarter expenses split out between support for the 1998 Funding Year and the 1999 Funding Year. We estimate that 35 percent of the \$4.2 million we project to need for expenses in the Third Quarter will be for 1998 Funding Year-related activities and 65 percent for 1999 Funding Year. That proportion will be even more heavily weighted to Funding Year 1999 in the Fourth Quarter, and, of course, there will be additional costs for funding 1999 next year.

Exhibit 1 shows more detail behind the Third Quarter estimate.

B. Prior Period Adjustment

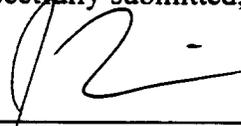
In the First Quarter 1998 filing that NECA did on SLC's behalf, there was an estimate of \$564,000 for start-up expenses for 1997 to be paid to NECA in that quarter. The actual payment was \$1.86 million. That filing also estimated SLC's First Quarter

1998 expenses at \$1.942 million. As we explained in our Second Quarter filing, NECA produced the First Quarter estimate (and the 1997 expenses as well) without a good sense of the likely demand for the program and without a detailed plan for program implementation. We are reviewing invoices submitted to the SLC by NECA and will provide final First Quarter expenses in a supplementary filing.

V. Next Filing

Pursuant to the Commission's rules,⁶ the next filing will be on or before August 1, 1998.

Respectfully submitted,



Ira Fishman
Chief Executive Officer
Schools and Libraries Corporation
1023 15th Street, N.W., Suite 200
Washington, DC 20005

May 1, 1998

⁶See 47 C.F.R. § 69.620(b).

Schools & Libraries Corporation
Third Quarter 1998 Budget Estimate
(Amounts in thousands)

SLC Operating	
Labor Costs	\$450
Travel, Supplies, Other	100
Contingency	<u>50</u>
Total	\$600

Non-Recurring Start-Up	\$600
------------------------	-------

NECA Operating	<u>\$3,000</u>
----------------	----------------

Total	<u><u>\$4,200</u></u>
-------	-----------------------

Expenses SLC	\$4,200
Expenses from USAC	200
Interest Income SLC	<u>(0)⁷</u>
Total	<u><u>\$4,400</u></u>

⁷ Interest earned in the Third Quarter will depend on the size of collections and on the amount and rate of disbursements in July. Therefore, this represents a very conservative assumption.

CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing filing was served this 1st day of May 1998, by mailing copies thereof by United States Mail, first class postage paid or by hand delivery, to the persons listed below.

By: 
Matthew Harcourt
SLC

The following parties were served:

Magalie Roman Salas*
Secretary
Federal Communications Commission
1919 M Street, N.W., Room 222
Washington, D.C. 20554
(Original and four copies)

International Transcription Service (ITS)*
1231 20th Street, N.W.
Washington, D.C. 20037

Chairman William E. Kennard*
Federal Communications Commission
1919 M Street, N.W., Room 814
Washington, D.C. 20554 (2 copies)

Commissioner Susan Ness*
Federal Communications Commission
1919 M Street, N.W., Room 832
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Commissioner Gloria Tristani*
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Julia Johnson
Chair, Florida Public Service Commission
2540 Shumard Oak Blvd.
Gerald Gunter Building
Tallahassee, FL 32399-0850

* - Hand delivered

ATTACHMENT D



1023 15th Street, N.W.
Suite 200
Washington, DC 20005
Phone: 202-289-2663
Fax: 202-289-7836

Ira Fishman
Chief Executive Officer

May 7, 1998

**Chairman William E. Kennard
Federal Communications Commission
1919 M Street, N.W., Room 814
Washington, DC 20554**

Dear Chairman Kennard:

Pursuant to your request, attached are the estimates requested by the Conference Report on H. R. 3579, regarding the requests for funding from schools and libraries. The estimates are based on the applications received as of April 28, 1998 in order to give as complete a projection as possible. The estimates are disaggregated by the eligible services and facilities and by discount level.

The overall projection of \$2.02 billion filed last week was based upon a statistical sampling that has a confidence level of 95% with a +/- 5% margin of error. The enclosed estimates of course are less precise because each item on the matrix is based on a subset of the overall sampling. If you have any questions, please do not hesitate to contact me.

Respectfully Submitted,

**Ira Fishman
Chief Executive Officer**

Board of Directors

Kathleen M. G'Quave
Chair
Schools & Libraries
Corporation
City Librarian
San Mateo Public Library

Henry R. Marcotte, Ed.D.
Vice Chair
Schools & Libraries Corporation
Council of Chief State School Officers
State Superintendent of Schools
West Virginia Department of Education

Kenneth D. Brody
Managing Partner
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Executive Director
National Schools Boards
Association
(NSBA)

Ira Fishman
Chief Executive Officer
Schools & Libraries
Corporation

Frank J. Gumper
Vice President
Long Range Public Policy
Bell Atlantic

Brian L. Talbot, Ph.D.
Executive Director
American Association of
Educational Service Agencies
Superintendent Educational
Service District 101

**Funding Request Analysis
May 5, 1998**

Disc. Range	Telcomm & Dedicated Serv.		Internet Access		Internal Connections		TOTAL	
	Post Disc. Sample	Post Disc. @ 30,759 apps.	Post Disc. Sample	Post Disc. @ 30,759 apps.	Post Disc. Sample	Post Disc. @ 30,759 apps.	Post Disc. Sample	Post Disc. @ 30,759 apps.
20 - 24%	\$ 396,700	\$ 1,337,655	\$ 48,316	\$ 156,174	\$ 731,941	\$ 2,468,073	\$ 1,174,956	\$ 3,961,902
25 - 39%	\$ 600,051	\$ 2,023,347	\$ 30,242	\$ 101,975	\$ 199,647	\$ 673,201	\$ 829,940	\$ 2,798,523
40 - 49%	\$ 25,557,123	\$ 86,177,543	\$ 3,262,658	\$ 11,001,544	\$ 36,195,410	\$ 122,049,400	\$ 65,015,191	\$ 219,228,487
50 - 59%	\$ 26,213,435	\$ 88,390,588	\$ 4,364,765	\$ 14,717,803	\$ 37,856,042	\$ 127,648,979	\$ 68,434,241	\$ 230,757,380
60 - 69%	\$ 31,410,928	\$ 105,916,327	\$ 5,510,168	\$ 18,580,056	\$ 49,383,728	\$ 166,519,852	\$ 86,304,824	\$ 291,016,235
70 - 79%	\$ 20,740,784	\$ 69,837,085	\$ 4,695,639	\$ 15,833,498	\$ 34,056,246	\$ 114,836,227	\$ 59,492,679	\$ 200,606,809
80 - 89%	\$ 80,140,147	\$ 202,790,045	\$ 6,430,103	\$ 21,682,035	\$ 140,810,395	\$ 474,132,333	\$ 207,180,645	\$ 698,604,413
90%	\$ 29,394,026	\$ 99,115,419	\$ 1,819,481	\$ 8,135,214	\$ 79,203,778	\$ 267,071,806	\$ 110,417,285	\$ 372,322,438
Total	\$ 194,453,204	\$ 655,688,020	\$ 26,159,371	\$ 88,208,299	\$ 378,237,166	\$ 1,275,399,870	\$ 598,849,762	\$ 2,019,298,189

ATTACHMENT E



FEDERAL COMMUNICATIONS COMMISSION
WASHINGTON

OFFICE OF
THE CHAIRMAN

May 7, 1998

The Honorable Thomas J. Bliley, Jr.
Chairman
Committee on Commerce
U.S. House of Representatives
2125 Rayburn House Office Building
Washington, D.C. 20515

Dear Mr. Chairman:

I am writing to respond to your request for a review of the impact on telephone ratepayers of the Commission's implementation of the universal service support mechanisms contained in the Telecommunications Act of 1996 ("the 1996 Act"), as to the changes that took effect January 1, 1998 through the first six months of the year.

As the following analysis by the Common Carrier Bureau and the Wireless Telecommunications Bureau shows, we have found that the changes in universal service support that were implemented January 1, 1998, did not increase the overall costs of long-distance carriers or the costs that local telephone companies need to collect in local rates. We are continuing our analysis of interstate long-distance rates to determine whether long-distance carrier rates have fully reflected the access charge reductions this Commission ordered to take effect on that date. For CMRS customers, we are finding that consumers have been seeing, and are continuing to see, reductions in prices even though the 1996 Act required for the first time that wireless carriers contribute to the support of universal service.

Long Distance Carriers:

Detailed analysis of the changes that took effect January 1, 1998 -- the charges that the interstate long-distance industry pays to local telephone companies and to support universal service -- shows no increase in long-distance carrier costs. Even taking the broadest view of universal service contributions by long-distance carriers, we find that increases in contributions for universal service support were offset by reductions in interstate access charges. As set out in the attached table, using projected 1998 demand and first quarter 1998 contribution factors, we conclude that IXC annual contributions to the new universal service mechanisms for 1998 should total approximately \$2.406 billion. At the same time, we find that, using projected 1998 demand, access charge costs to IXCs decreased by approximately \$1.46 billion annually as of January 1, 1998. In addition, starting January 1, 1998, IXCs no longer had to contribute \$0.53 per line to the former universal service fund that provided low-income and high-cost support, saving them an additional \$980 million in 1998. The total IXC cost reductions from these two sources total \$2.44 billion. Thus, while there were significant changes to the structure of the interstate access charges and universal service costs on

January 1, 1998, the overall cost of these two items to IXCs did not increase on January 1, 1998. Therefore, we see no need for overall long-distance carrier rate increases as the result of these universal service changes.

As you may know, we are currently analyzing whether long-distance carriers have reflected these changes in their rates to end users. A number of long-distance carriers have decided to levy new line items on customer bills over the past few months. These decisions were made by the carriers themselves. As explained above, there was no overall cost increase on January 1 to long-distance carriers and therefore no regulatory justification for any rate increases. IXCs have asserted that new billing line items have been offset by reductions in per-minute toll calling rates. Because the long-distance market is competitive and the Commission, therefore, does not regulate long-distance rates, the Commission currently does not have sufficiently detailed data to verify these claims. On February 26, 1998, I sent letters to the three major long-distance carriers seeking a response to claims that they have not flowed through access charge reductions to their consumers but have increased their overall rates. We have received responses from those carriers, and we are in the process of evaluating the extent to which they have in fact flowed through access charge reductions.

In addition, as shown on the attached chart, the Commission's access reform decisions reduced IXC common line access charges as of January 1, 1998, by \$815 million annually. These decisions have reduced implicit subsidies and facilitated the development of competition by aligning certain common line rates with the manner in which LECs incur the costs of providing service. Specifically, the Commission has reduced the subsidy for non-primary residential and multi-line business lines by identifying additional costs that should be recovered through flat-rate charges instead of through per-minute charges, and by raising the ceiling on flat-rate charges that end users pay for these lines. These changes eliminate some of the implicit subsidies that were present in the old access charge regime and have reduced long-distance carrier access bills substantially.

Local Exchange Carriers:

The various universal service changes implemented January 1, 1998, should have had no effect on local exchange rates, which are regulated by state public service commissions. Those changes did not reduce the amount of federal high-cost support that local telephone companies have been receiving for their customers. The major changes instead affected the manner in which such support has been collected, expanding the pool of contributors from just interstate long-distance carriers to all interstate telecommunications carriers.

CMRS Carriers:

CMRS carriers' costs have declined in recent years. And, as competition increases, we have seen the rates that CMRS customers decline as well. As a result, CMRS customers pay

less for service today than they did even one year ago, notwithstanding wireless carriers' new universal service obligations.

Since passage of the 1996 Act, cellular carriers have taken advantage of its provisions to renegotiate their existing interconnection agreements with incumbent LECs, and new broadband PCS entrants have been able to reach interconnection agreements for the first time. Most of these interconnection agreements have been negotiated on a voluntary basis, but in many cases the parties have had to resort to arbitration. Many of the agreements, whether voluntary or arbitrated, are in effect pending final State cost decisions.

The charges in these new agreements that CMRS providers pay to local telephone carriers to terminate calls to customers on the wireline network, known as Transport and Termination (T&T) rates, are much lower and more cost-based than pre-Act rates. T&T rates now average about .8 cents per minute for the most common type of LEC-CMRS interconnection. Prior to passage of the 1996 Act, wireless carriers paid an average rate of approximately 3 cents per minute to LECs for the completion of mobile-to-wireline calls. Moreover, T&T arrangements at that time also typically provided for no payments from LECs to wireless carriers for the costs of terminating wireline-to-mobile calls.

The Wireless Telecommunications Bureau estimates that the reduction in LEC-CMRS T&T rates has thus far generated from \$660 million to \$900 million in annual savings for broadband CMRS carriers. The annual savings will grow in the future as total wireless minutes of use grow. Moreover, given the increasing competitiveness of the CMRS sector, the bulk of these savings should be passed on to CMRS customers.

The 1996 Act, for the first time, did impose federal universal service support obligations on all "providers of interstate telecommunications services," including wireless carriers. As a result, as of January 1, 1998, the Commission now requires wireless carriers to contribute to federal universal service support. Based on their contributions during the first half of 1998, the annual contribution of CMRS carriers should be less than \$300 million. As with interstate long-distance carriers, the Commission does not regulate wireless carrier rates to consumers, including how they choose to recover their universal service contributions from their customers. Some have chosen to include those costs on customer bills, while others have not.

Our analysis of available information demonstrates, however, that CMRS customers have been seeing significant overall reductions in their rates. While we are not aware of any sources of information that track mobile telephone prices in a comprehensive and systematic manner, there are a number of reports available indicating that prices are falling substantially.

Analysts generally agree that mobile telephone prices, defined as dollars per minute of use, have declined significantly over the past few years, though they differ a bit on the reported magnitude. For example, The Robinson-Humphrey Company estimates that from

April 1997 to December 1997, the average available price of cellular service and PCS dropped 12.3% for low-end users, 28.8% for mid-level users, and 31.1% for high-end users. The Yankee Group estimates that the average price has dropped 25% in markets where at least one PCS firm has begun service. The Yankee Group also finds that the most expensive price plans in some cities are now approximately \$0.50 per minute for the average customer, and that cheapest price plans in the least expensive cities are in the mid \$0.20 per minute range.

New PCS entrants are typically pricing their services below the incumbent cellular operators. For example, The Robinson-Humphrey Company finds that, at the end of the December 1997, PCS prices were between 16.5% and 20.3% below their cellular competitors. The Yankee Group reports that, as of September 1997, PCS prices were averaging 20% below analog cellular in major cities where at least one PCS competitor is operating.

Finally, the Cellular Telephone Industry Association reports that the average monthly bill (as opposed to average price per minute of use) for cellular, broadband PCS, and Enhanced SMR subscribers fell 14% -- from \$51.00 to \$43.86 -- between December 1995 and June 1997.

Conclusion

In conclusion, Mr. Chairman, our analysis shows a continuation in the historic downward trend of overall telecommunication rates. As the Commission implements universal service under the 1996 Act, I look forward to the opportunity to talk with you personally about this issue and to assist you in any way. Thank you again for the opportunity to address your questions and concerns.

Sincerely,



William E. Kennard
Chairman

Changes in Interstate Interexchange Carrier Costs
Occuring on January 1, 1998 (in Millions of Dollars)

<u>Exogenous Cost Changes</u>	<u>1/1/98</u>
Long Term Support	(493)
Universal Service Flowback	783
Reversal of Bell Atl. OB&C Overcharge Adjustment	(11)
Equal Access Expense	(33)
Revision to Facilities-Based TIC	(10)
Marketing Expense	10
Part 69 GSF Rule Change, CC Dk 96-262	(190)
Central Office Maintenance Cost	(4)
Other, including DEM Weighting Changes	(30)
<i>Total Exogenous</i>	<u>22</u>
<hr/>	
<u>Other Adjustments</u>	
Decline Due to Understated BFP, CC DK 97-149	(101)
Decline in IXC Charges Due to SLC Increases	(815)
PICCs	1,859
Reduction in per-minute charges due to PICCs	(1,859)
PICC Charges not paid by IXCs (Non-Pre subscribed Lines)	(90)
Use of headroom to offset PCI changes	41
Miscellaneous Effects, including Mid-Year Filings	(15)
DEM & USF Flowthrough Changes, Rate of Return LECs	(268)
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Access Charge Reduction at Base Period Demand	(1,225)
Effect of Growth in Demand to 1998 Levels*	(185)
Additional Reductions in IXC Costs	
CC Dk 97-149 Refund (Jan. 1998)	(50)
<hr/>	
Total Reduction In IXC Access Costs	(1,461)
Elimination of Old High Cost Fund Payments	(980)
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Total Reduction In IXC Costs	(2,441)
New Explicit Universal Service Payments by IXCs	2,406
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Net Change in IXC Costs	(35)

* Assuming 6% annual growth in minutes of use and 4.5% growth in PICCs;
 PICCs are assumed to grow somewhat faster than lines because
 line growth is largely in multi-line business and non-primary lines.

Separate Statement
of
Commissioner Susan Ness

Re: Report in Response to Senate Bill 1768 and Conference Report on H.R. 3579

I welcome today's opportunity for the Commission to respond to concerns that have been expressed by Congress. We have no greater responsibility, or challenge, than to implement successfully the Telecommunications Act of 1996. An active and continuing dialogue between the FCC and Congress is important to keeping implementation on track. We do our best to follow the statute as Congress wrote it, but, to the extent that we receive additional congressional guidance on ways in which our implementation decisions can be improved, I am happy to be responsive.

In particular, there have been significant congressional concerns about the administrative structures that were established to administer various universal service support mechanisms. Although I firmly believe that the structures previously established were suited to the goals of efficiency and accountability, and consistent with our statutory authority, it is clear that Congress believes the job can be done better if, at a minimum, the Schools and Library Corporation and the Rural Health Care Corporation are combined in a single entity. I believe we should follow this guidance and that the best way to do so probably is to fold both SLC and RHCC into the Universal Service Administrative Corporation.

A final decision, of course, should await the development of a specific proposal, the opportunity for deliberations by the Commission and the state members of the Federal-State Joint Board on universal service, and confirmation from Congress that the revised structure will meet with approval. It is my sincere hope that this approach will not only receive congressional support but also meet the needs of the intended beneficiaries of the universal service provisions of the Telecommunications Act.

Similarly, if Congress has concerns about the salaries paid to the senior employees of SLC, RHCC, USAC, or NECA, then it is our responsibility to take responsive action. Funds used for administration of the high-cost, low-income, or school, library, and rural health support mechanisms necessarily diminish, to some degree, the funds that will be available for the beneficiaries of the programs. Although these corporations require capable administrators, and the boards of directors of each of these associations have made independent decisions about the

salaries they pay their executives, the unambiguous wishes of Congress must be respected -- and followed.

This report also provides valuable information about the manner in which universal service support is being collected. The key point this report demonstrates is that universal service funding for schools, libraries, and rural health care is being collected without necessitating increases in the costs of services to telecommunications consumers. Access charge reductions, in particular, coupled with growth in the industry, declining costs, increased competition, and the elimination of deadweight losses, enable the new universal service support mechanisms to be initiated -- and the low-income and high-cost programs to be maintained -- while aggregate prices to consumers continue to decline. There is, to be sure, a growing amount of confusion about various line-items that are appearing on consumers' bills, and I believe we should be forceful in acting to ensure that these charges are not misleading or inappropriate. But the line on the bill that matters most is the bottom line, and that's the line we are working hardest to reduce.

I want to work with Congress to ensure that the Telecommunications Act is a resounding success. I strongly believe that Congress acted wisely in deciding to expand the traditional notion of universal service by supporting the connection of classrooms and libraries to the information superhighway. I will continue to work to ensure that this vision -- which is so crucial to our success as a nation in the 21st century -- is successfully implemented, with congressional guidance and support.

DISSENTING STATEMENT OF COMMISSIONER
HAROLD FURCHTGOTT-ROTH

Re: Universal Service Report to Congress in Response to Senate bill 1768 and Conference Report on HR 3579.

Introduction

I regretfully dissent from the majority's Report to Congress on universal service. I remain concerned that the Commission fails to address the underlying frustration that many members of Congress, and the general public feel, as a result of the Commission's misguided Universal Service Order last May.

As I stated only a month ago in this Commission's last report to Congress: priorities matter. I remain convinced that rural, high-cost universal service is not just one of many objectives of Section 254; it should be the highest priority. The federal government has had universal service programs for rural, high-cost areas and for low-income Americans for many years. Section 254 embodied these ideals and set forth goals that emphasize rural, high-cost support as well as low-income support and other objectives. Instead of such an emphasis, we have made costly promises for some services without making promises for increases in rural, high-cost programs. Rural, high-cost universal service issues should not be resolved and implemented in some dim and distant future after all other universal service issues have been resolved; rural, high-cost universal service issues should be resolved and implemented first. Rural, high-cost universal service should not be viewed as the residual after enormous amounts for other federal universal service obligations have been promised; rural, high-cost universal service should receive the lion's share of any increase in the federal universal service fund.

This Report provides another missed opportunity, and the accompanying structural changes to the Schools and Libraries Corporation that are required by it provide another reason, for the Commission to put on hold its plans to implement a far-reaching schools and libraries program until after it has finished implementing the rural, high-cost fund issues. I also object to the majority's continued refusal to allow any of the benefits of reduced access charges to actually flow to consumers. For these and other reasons explained below, I must reluctantly and respectfully dissent from the majority opinion today.

I. Public Funds Should Not Be Allocated for Schools and Libraries Until the Proposed Restructuring Has Been Completed.

The proposal for consolidating the three corporations is a good first step in reaching a more rational, efficient, and legal structure to administer universal service. I have several reservations, however, with the specifics of the proposal. First, I am concerned that the proposal merely perpetuates too much of the current bureaucracy. For example, it appears that the majority would simply fold the current Schools and Libraries and Rural Health Care Corporations into USAC in their entirety, with the new "operational units" maintaining virtual autonomy as they would have the power to bind the USAC Board regarding matters within their expertise.⁷⁸ I am concerned that the ultimate reorganization/streamlining plan obtain the benefits of economies of scale and consolidate the ultimate responsibility for universal service into one decision-maker.

The consolidation of the ultimate decision-making authority is also important for accountability. I am concerned that adequate safeguards may not have been implemented to prevent fraud and abuse. Recently, there have been complaints that some schools and libraries are basing their award of contracts on the amount of ineligible items that the bidder is willing to provide at "no cost." Such actions could encourage bidders to inflate the cost of eligible services, to provide ineligible services for free. This is the type of behavior that the Commission must ensure is not taking place prior to the disbursement of any public funds.

I also remain concerned that the majority fails to address fully the issues raised by the GAO report regarding the legality of the Commission creating these corporations without specific statutory authority. I commend the majority for seeking Congressional guidance regarding this issue. I remain convinced, however, that the Commission should explicitly acknowledge the legitimacy of GAO's conclusions regarding the legality of these corporations, and wait for Congressional approval of the revised structure prior to further expenditure of any funds. I fail to see how the Commission can direct that these corporations continue to act without first receiving the requisite authorization from Congress.

In addition, I would take this opportunity to clarify that the full Commission must take a more active role in the direct oversight of these quasi-public companies. Congress clearly favors a more efficient organization of only limited administrative functions, without the ability to "interpret the intent of Congress" or "any rule promulgated by the Commission."⁷⁹ Yet, the majority indicates that the revised entity might be able to apply its expertise to interpreting and

⁷⁸ Report at footnote 33, para. 11.

⁷⁹ Section 2005(b) of Senate bill 1768.

applying existing "decisional principles."⁸⁰ I am concerned that, while a good start, the majority does not go far enough in delineating specific means of ensuring full Commission involvement in all budgetary decisions and the policy-making process.⁸¹ As it will take some time to restructure the universal service corporations, it would be prudent and in the taxpayers interest to suspend further expenditures on schools and libraries.

II. The Excessive Funding Proposed for Schools and Libraries Will Harm Consumers and Increase Telecommunication Rates

I also object to the majority's conclusions regarding the funding that has been provided to the schools and libraries program. For the following reasons, I disagree with the majority's conclusion that the steps the Commission has taken thus far were necessary to assure that the schools and libraries funding mechanism was adequately funded and the program delivered efficiently.⁸²

First, as I have stated previously, the size and scope of the current schools and libraries program is in excess of what was envisioned by Congress, and thus beyond the Commission's authority to establish. Nothing in the statute or the legislative history indicates that Congress contemplated substantial new taxes on interstate or other telecommunications services as a result of the Telecommunications Act of 1996, nor did it envision price increases -- much less substantial price increases -- in any telecommunications market.⁸³

The Schools and Libraries Corporation projected that, as of May 1, 1998, \$2.02 billion in discounts has been requested by applicants. Although current Commission rules cap the program at \$2.25 billion or demand, the report indicates that the Commission will seek comment on whether the amount collected this year should equal demand or "be limited to an amount that does not cause long distance rates to increase."⁸⁴ While I certainly agree that the Commission should

⁸⁰ Report at para. 14.

⁸¹ For example, I am concerned that about the degree of oversight that is being exercised regarding administrative and start-up costs. In their latest filing, the Schools and Libraries Corporation indicates that it paid NECA \$1.86 million in start-up costs, more than three times the original estimate, and it is still not able to provide an accurate estimate of all its administrative costs for the first quarter. Third Quarter 1998 Fund Size Requirements for the Schools and Libraries universal Service Program, dated May 1, 1998.

⁸² Report at para. 16.

⁸³ See for example, the comments of Sen. Slade Gorton, at a Hearing before the Subcommittee on Communications of the Senate Committee on Commerce, Science, and Transportation, March 25, 1998; and the comments of Rep. Michael Oxley at a Hearing before the Telecommunications, Trade, and Consumer Protection Subcommittee of the House Committee on Commerce, March 31, 1998.

⁸⁴ Report at para. 23.

not collect any revenues that would cause long distance rates to "increase," I remain frustrated that the majority assumes that any reduction in access charges should be "used" for new universal service programs, instead of turning any of the reductions back to consumers. Unfortunately, the majority indicates its intention to use the entire \$700 million in access charge reductions estimated for July to increase the quarterly contributions to the schools and libraries program from \$325 million to approximately \$524 million for a fund of \$1.67 billion for 1998. This amount is not only excessive but prevents consumers from receiving any of the benefits of deregulation.

Chairman Kennard's letter to Chairman Bliley, Attachment E to this Report, entirely misses this point. The issue is not whether, despite massive tax increases that just offset decreases in federal access fee and charges, IXCs have no net differences in costs. The issue is whether, absent massive new taxes, consumers would be better off. By the Bureau's own analysis, consumers are bearing \$2.4 billion in new costs in 1998 alone. How much lower might prices have been? How much more might the promise of the 1996 Act of lower prices for consumers been fulfilled? How many more businesses might have been spawned? Professor J. Hausman has estimated that consumers lose more than \$2 for every \$1 paid in taxes on long-distance services.⁸⁵ Thus, the FCC had an opportunity to put more than \$5 billion back in the pockets of ordinary Americans. But the FCC has chosen not to.

There is implicit in the Bureau's calculations a set of new taxes that just balances a reduction in federal charges and fees. Is this balance coincidental or the artifact of a private deal between industry and the Commission? The promise of the 1996 Act was that rates would come down, not that they would remain the same as the result of secret deals in which one set of federal taxes goes down and another goes up, while citizens are none the worse for the regulatory sleight of hand. Are we left to believe that if access charges and other fees had been reduced by only \$200 million, that new universal service taxes would have been only \$200 million? Or that if fee reductions had been \$5 billion that new taxes would have been \$5 billion? Moreover, there is no assurance that the consumers who benefit from access reductions will be the same consumers who will bear the new universal service burden. For example, business consumers could disproportionately benefit from the access charge reduction while residential consumers pay for new universal service fees.

Second, I am concerned that the majority continues to use all access reductions for new universal service fees while the high-cost program has not been fully implemented. As I argued in our previous report to Congress, "the potential pot of revenue that the FCC can collect for universal service from fees on interstate services is limited." Some potential universal service beneficiaries have been "promised" enormous and unending benefits, long before there are actual revenues for these programs and long before other potential universal service beneficiaries (rural, high-cost programs) have voiced all of their concerns.

⁸⁵ Jerry Hausman, "Taxation by Telecommunications Regulation," National Bureau for Economic Research, Working Paper Series 6260, November 1997.

Third, the plan outlined in the Report not only uses every cent of access charge reduction for new universal service programs, it will actually cause an increase in fees for some telecommunication services. Buried in the Report is the proposition that a \$700 million reduction in access charges will yield \$848 million in additional funds for schools and libraries.⁸⁶ How is this possible? Because the majority anticipates increasing all contribution rates equally, even though almost 20% of the schools and libraries contributors will not benefit from reduced access charges. Thus, for example, wireless carriers will be required to pay proportionately higher costs, despite the fact that they have received no access charge reduction.

Fourth, I also note that this entire dilemma has been caused, at least in part, by the Commission's misguided and unlawful decision to fund inside wiring and other non-telecommunications services. As I explained in the April 10th report to Congress, the Commission has no statutory basis to provide direct financial support for non-telecommunications services and to non-telecommunications carriers. According to the Schools and Libraries Corporations own estimates, the vast majority of the program's demand is for non-telecommunications services and facilities.⁸⁷ The vast majority of demand is for funds to provide inside wiring -- what should be an ineligible facility. Indeed, the amount already collected this year would almost fully fund the demand for telecom services.

At a minimum, I believe the Commission should reduce the current quarterly contribution rate for schools and libraries from \$325 million to a mere \$25 million. Such a reduction would allow previous access charge reductions and those contemplated for this July to flow to consumers directly, while still providing more than sufficient funds -- \$675 million for 1998 -- to pay for all of the telecommunications services that have been requested by any school this year. The Commission would then have until January 1, 1999 to reevaluate the scope and scale of the schools and libraries program, while also finishing what should have been its first priority, namely, the rural and high-cost program.

In addition, I am concerned with the report's suggestion that carriers should conceal their universal service contributions from consumers. As I have stated previously, no carrier should have its billing information restricted or limited by the Commission. The Commission has explicitly provided carriers with the flexibility to decide how to recover their payments, including as charges on consumers bills, and I am concerned by implications that such charges are fraudulent or misrepresentations. Indeed, section 254(e) requires that funding mechanisms for universal service be explicit. Consumers have a right to know what federal charges they are paying; the Commission should not discourage companies from placing universal service charges on their bills.

⁸⁶ Footnote 73 accompanying para. 24.

⁸⁷ Attachment D; total demand for telecom services is only \$655,688,020, while total demand for internet services is \$88,208,299 and total demand for internal connections is \$1,275,399,870.

Finally, I continue to believe that the Commission erred in assessing contributions to the schools and libraries and rural health care programs based on intrastate revenues. Any federal assessment on intrastate revenues is beyond the Commission's authority. Section 2(b) of the Communications Act creates a system of dual federal-state regulation for telecommunications. In essence, the Act establishes federal authority over interstate communications services while protecting state jurisdiction over intrastate services. I believe that the Commission's decision to look to intrastate revenues to determine federal universal service support and to establish a minimum discount for intrastate telecommunications services for schools and libraries impermissibly encroaches on state's rights and violates the Act's fundamental federal-state dichotomy.

Conclusion

Section 254 is an integral part of the Telecommunications Act of 1996. The Commission has yet to implement it properly, despite repeated opportunities. The proper implementation of section 254 should be of the highest priority.

SEPARATE STATEMENT OF COMMISSIONER MICHAEL K. POWELL,
DISSENTING

Re: Report in Response to Senate Bill 1768 and Conference Report on H.R. 3579.

I write separately to explain why I am dissenting from this Report to Congress. The Common Carrier Bureau has done an admirable job of drafting the text of this Report over the last several weeks despite uncertainties regarding whether Congress would ultimately request the Report and what that request would entail. As a result of poor internal Commission processing, however, I have not been given a full opportunity to consider and influence the content of this Report. Because I do have some concerns with the content of the Report, I feel I have no choice but to dissent.

In the interest of being responsive to Congress, however, I briefly describe below some of my concerns regarding the Report and our universal service programs generally:

- ! I am increasingly troubled by the suggestion, evidenced in the Report, that carriers should conceal their universal service contributions or not allow carriers to recover such contributions from consumers. Section 254(e) of the Act expressly mandates that universal service support be "explicit." 47 U.S.C. § 254(e). Further, as the Report recognizes, carriers have the flexibility to decide how they will recover their universal service contributions, and I doubt the Commission has authority to prevent carriers from recovering from their customers. My fear is that, rather than accept our apparent lack of authority to prevent carriers from passing their contributions on to their customers, the Commission will continue down the road, as evidenced in the Report, of suggesting that politically-unpopular methods of recovering such contributions (i.e., line items on consumer telephone bills) somehow amount to fraud or misrepresentation. Clearly, carriers should not be allowed to commit fraud or misrepresentation. Yet I am hesitant to suggest that carriers are guilty of these offenses simply because they inform their customers that a component of their bills will be used to recover contributions mandated by the government. To the extent we are, as a practical matter, scrutinizing statements and line items on bills to pressure carriers into hiding from the customer support mechanisms that the Act requires be made explicit, I must respectfully object. I also must object to the notion, implicit in some calls for scrutiny of carriers' bills, that carriers commit misrepresentation if they do not indicate that they have benefited from access reductions at the same time they make their recovery of universal service contributions explicit on customer bills.

- ! I seriously question the Report's suggestion that the starting point for determining the appropriate level of funding for the Schools and Libraries program should be an assumption that all reductions in access charges be used to fund that program. The Commission should acknowledge that the Act's addition of various universal service programs to the traditional high cost, low income and other programs will require the overall amount of universal service subsidies to rise relative to the sum of implicit and other subsidies that existed prior to the Act's passage. At the very least, we should expect that carriers will seek to recover their contributions to these additional, new programs from their customers. Indeed, I believe it would be inconsistent with the statutory mandate that universal service support be made explicit if the Commission were to -- formally or informally -- attempt to force carriers to conceal from customers the recovery of costs attributable to government-mandated programs. The Act mandates that we compensate for reductions in implicit access charges by adding explicit universal service subsidies. Consequently, "access charge reductions" cannot be viewed as a quid pro quo for lowering or eliminating the amounts carriers recover as explicit line items on customers bills. Moreover, I seriously question the validity of tying the funding level of any of our universal service programs to reductions in access charges.

- ! I also am concerned that a sizeable portion of demand for the Schools and Libraries program is attributable to discounts for internal connections and Internet access, which the Commission is not required to fund as advanced services pursuant to section 254(h); rather, the Commission could decide to postpone funding internal connection and Internet access discounts temporarily or indefinitely. (It is noteworthy that, had the Commission decided not to fund internal connections and Internet access at this time, funds collected for the first 6 months of 1998 would likely cover the demand by schools and libraries for discounted telecommunications services.)

- ! I would support limiting the revenue base of the Schools and Libraries program to interstate revenues. I remain unconvinced that there is a principled basis for assessing contributions based on both intrastate and interstate revenues for that program, while limiting assessment of contributions for other universal service programs to interstate revenues.

- ! I am not yet persuaded that, contrary to the analysis of the General Accounting Office, the Commission acted lawfully in directing that NECA establish the Schools and Libraries Corporation and the Rural Health Care Corporation as a condition of its appointment as temporary administrator. Under the Government Corporation Control Act, "[a]n agency may establish or acquire a corporation to act as an agency only by or under a law of the United States specifically authorizing the action." 31 U.S.C. § 9102. To my knowledge, no law specifically authorizes the Commission to establish corporations, and I find arguments that the

Commission merely directed the establishment of the corporations as a condition of appointment unavailing. If there is a distinction between directing the establishment of the corporations as a condition of appointment and establishing the corporations outright, it appears to be a distinction without a meaningful difference.

I also note that Commissioner Furchtgott-Roth raises additional, serious concerns in his statement dissenting from this Report. Had the Commission's internal processes afforded me more of an opportunity to engage with my colleagues regarding the contents of this Report, I might have been persuaded that there are equally valid arguments in opposition to the criticisms I highlight above. Regrettably, that opportunity was never presented.

As I stated in my statement for the April 10, 1998 Report to Congress, I fear that support for these beneficial programs will erode among both legislators and the general public if we cannot find a way to make critics in Congress and elsewhere believe that we are working to preserve and advance universal service in a prudent and responsible manner. With the issuance of this Report, I regret that we pass up yet another opportunity to foster such belief, in part, because we failed to allow for full consideration of this matter by the entire Commission.